RESEARCH NOTE

FROM INFORMAL TO FORMAL MICROFINANCE REVISITED: THE HIMALAYA SAVINGS AND FINANCE COMPANY IN NEPAL

Hans Dieter Seibel
Uttam Dhakhwa
Heiko Schrader

Origins of *Dhikuti*[1]

Himalaya Finance and Savings Company traces its origins back to an age-old institution, the *dhikuti* or *dhukuti*. It is called in the Nepali language, *dhikur* (literally, storage book for valuables of food grains) among the Thakali, the ethnic group originally living in the Kali Gandaki valley and having been engaged in the trans-Himalayan trade (Schrader 1988) where it appears to have emerged centuries ago (Fürer-Haimendorff 1975; Bista 1971; Messerschmidt 1972, 1978, 1981; Dolebel 1985). There is only very scanty information on the earlier period, but like among a number of rotating savings and credit associations (see Bauman 1994, Schrader 1991) its first form was probably that of a social reserve fund with contributions in grain from which members could obtain assistance in case of emergency. By the middle of this century, cash had replaced kind, and the *dhikuti* had become a ROSCA (Rotating Savings and Credit Association) among Thakali businessmen who established themselves in the growing Nepalese economy with the purpose of capital formation. Groups were usually small (20-30 members), although sometimes the number of members exceeded 100 (Von der Heide 1985); the cycle of rotation was usually annual, access was principally open (no caste, gender or ethnic restrictions); drawing the fund was generally on the basis of lot.

During the past half century *dhikuti* as financial institutions has been spreading all over the country and becoming the small businessman's self-help bank (Seibel 1988). This was mainly due to the extension of the money economy, the increase in business opportunities, an upsurge in the demand for money and, at the same time, the absence of formal financial

Contributions to Nepalese Studies, Vol. 25, No. 2 (July 1998), 269-277

institutions with convenient savings deposit facilities and reasonable access to credit. During that process of expansion, the *dhikuti* underwent two major changes: the cycle of rotation changed from annual to monthly, and secret bidding, with the fund allocated to the lowest bidder[2] and a simultaneous reduction of individual contributions, replaced other modes of fund allocation such as a predetermined sequence or the drawing of lots.

Weaknesses of the *dhikuti*

In 1988 when Seibel first studied the *dhikuti*, they functioned very well and there was little evidence that a process of merging of these institutions into credit institutions began. A proposal was presented how such an institutional change might be initiated. The idea was to introduce permanent funds from which members could obtain loans at market rates of interest whenever needed and successful in bidding. To build up such funds, in a first step the balance between the agreed-upon total amount of contributions and the actual bidding amount could be deposited in a permanent fund, in a second step the institutions could be linked to banks (Archarya, Shrestha and Seibel 1990). However this was not the course history took.

During the 90s the word spread out in Kathmandu like in a number of Asian countries that such ROSCA was a risky venture. In spite of a number of "insurance mechanisms" such as a direct redistribution of the fund or sometimes guarantors in case of default, one risk remained in the auctioning. More and more people placed bids of unreasonably low amounts to get the fund immediately, aiming at a higher profit from the investment. When these expectations fell through, they found themselves unable to abide by their obligations and dropped out of the *dhikuti* before its conclusion. In 1995 it was estimated that roughly one-third of the *dhikuti* in Kathmandu came to such a premature end (Bajracharya 1995). Redress to litigation was difficult as the *dhikuti* is an informal institution outside the protection of the law.

Organising *dhikuti* became something like a profession, and many *dhikutis* were headed by organisers in charge of several *dhikutis* at the same time. As a reward, the organiser had the privilege of obtaining the first round in a cycle; but he also was liable for its proper conclusion. It is not clear how they managed the risk of *dhikuti* failures.

A former government officer, H.B. Pradhananga, saw a chance to engender a financial institution which might better fit the requirements of the people. He analysed several weaknesses in the *dhikuti* system as it had evolved: the lack of access to credit when needed; the speculative nature and moral hazard of bidding; the rigidity of fixed monthly contributions; the failure of the system to mobilise savings as they occurred, and the drop-out danger of early recipients of the fund. He also saw that the vast majority of people in Nepal make their money in the informal sector, where income is irregular and daily, rather than regular and monthly. If small excess incomes are not collected on the spot, they are consumed and fail to be converted into savings. Furthermore, he realised that the craving for access to credit was largely due to the absence of savings deposit facilities. As people wasted their daily income, they recurrently needed credit to finance their investments or working capital requirements.

From monthly rotating savings accumulation to daily deposit collection

In 1989 Pradhananga set the initial step to his present well-flourishing enterprise. He organised three groups of 25 members each and employed a collector for deposit collection at doorstep Rs 10 from each group member every day. Attempts to register the groups or the overall business failed as there was no appropriate legal status for that kind of money business. To be registered as a bank, with its exorbitant equity capital requirements, the operation was definitely far too small.

H.B. Pradhananga found the start difficult for initially people were distrustful. Groups met every month to check whether their money was still safe. As confidence grew, the word spread, and within one year, in 1990, the number of groups had risen to 200, comprising a total of 5,000 participants. At a rate of Rs. 10 per day, the daily collection amounted to Rs. 50,000. This corresponded to about Rs. 20 million annually.

Registering as a Finance Company Limited

In 1992 the Government passed a Finance Company Act. H.B. Pradhananga took a giant step on the evolutionary scale of organisational morphogenesis and registered his business under that act as the Himalaya Finance & Savings Company (HFSC). The institution got a formal status.

The existing groups continued to maintain their group structure but switched to annual meetings. In the acquisition of new business, however, H.B. Pradhananga abandoned the group approach and went into straight daily savings collection. For the new clientele, HFSC holds meeting annually. In the eyes of the participants, legal status with its inherent supervision is a substitute for direct monthly control.

By May 1996, HFSC had established 49 branch offices all over the country in addition to its head office in Kathmandu. It employed 600 collectors, with each serving between 125 and 400 clients a day by bicycle, motorcycle or by walking. The monthly salary of a collector, depending on the number of clients, amounted to Rs. 3,000.

By April 1998, due to legislative requirements, Pradhananga had changed the structure once again: 43 collection offices, four branch offices (Biratnagar, Birganj, Janakpur, Lalitpur), one city office (Sundhara, Kathmandu) in addition to the head office Tahachal, Kathmandu. Five further branch offices are in the process of being installed. The offices cover 43 of 75 districts. The number of employees of city and head office alone account for almost 100 people, in all offices around 300 people excluded the door-step service collectors. The branches deliver their daily hand-written reports and book-keeping by fax, and the head office works up the data in a computerised form. In the near future also the branch offices would be computerised so that a data transfer can be done more easily via electronic media. Also the collection has become more efficient. The number of collectors has been reduced to 98, each of them getting a salary as a percentage (now 3%) of daily collection (collecting between Rs. 10,000 to 15,000 per day per person), which has increased their salaries. They serve as many as 52,000 savers all over southern Nepal, the Kathmandu and Pokhara valleys. Also the savings amount increased from Rs. 10 to Rs. 10-500 until March 1998, depending on the ability of the savers. Advertisement for the company is done through newspapers, radio and television.

Savings products

Participants enter into a savings contract for a period of three years after which their savings are returned to them including interest. They have a choice between having their savings collected or depositing them directly in the branch. On collected savings, the annual interest rate was 9% in 1996 and now has decreased to 7%; on deposited savings it was and is still 11%. ~~There are~~ thus two savings products;

(1) one of savings collection at 7% interest;
(2) the other one of savings depositing at an office at 11% interest.

If participants break their savings contract within the first three months, no interest will be paid to them at the end of the three-year contract period.

Door-step service

We accompanied a senior collector on his door-step service. He has been working for the company for already six years. He starts at ten o'clock in the morning, leaving the head office of the company by bicycle. Close by, on his way to his collection area in Chabahil, Mahankal, Boudha and Jorpati - about three quarters of an hour away - he already passes four customers. The first customer is an about 50- year old woman, the owner of a small food store. According to her three-year savings contract she deposits Rs 100 per day into her savings account. The collector signs the receipt in her savings book which she keeps in her shop. The first page of the book outlines the name of the customer and his account number with his photograph. The following pages provide columns for the date, particularities, the savings amount and the signature of the collector. In return the customer has to sign the collector's list. It lists the following columns: current number, saver's account number, name and address, savings amount, savings interest (now 7% for collected savings) and customer's signature. The whole transaction takes 15 to 20 seconds.

Just one shop to the left are the next two customers from one family: young mother and six to seven- year-old child. The family runs a small shoe stall. The mother pays Rs 100 per day into her savings account and Rs 50 per day into the child's. This means that she saves Rs 4,500 per month which is a considerably high sum compared to the average customers of the collectors. She says that she and her husband opened the child's account to save for its education.

The third customer is a middle-aged woman at a small food store who saves Rs 20 per day, the same as the forth customer, a man who again runs a small shoes stall.

The way to his first collection area where he lives takes around half an hour. The next customer runs a small communication centre, but he is not available at that moment. This means that the collector has to return later. The sixth customer, male, about 30 years, runs a small food shop and saves Rs. 25 per day, which is a typical amount of savings.

The collection continues in this way. Altogether this collector has around 300 customers (100 more than on average) which he, however, cannot serve within one day. Therefore he collects from half of them double the amount every second day. On average he comes back to the office around 5 o'clock in the evening with total savings, amounting to Rs. 8,000. The settlement at the head office takes 10 minutes, and 3 percent of the total savings collected are his salary: around Rs. 240 (or roughly Rs. 7,000 per month).

On a whole savings per day can be categorised as follows:

- Rs. 10 grassroot-level people;
- Rs. 20-50: low-income people; smallest shops
- Rs. 100-500: small businessmen, small cottage industries, etc.

More rich people, on the other hand, deposit amounts of more than Rs 10,000 per year.

Loan products

Loans may be granted to participants and non-participants. However, members have priority and can get a loan at any time without collateral; loan processing takes about two days. Non-members have to undergo thorough loan examination procedures and provide solid collateral. The maximum loan size is Rs. 3 million for both members and non-members. There are thus two major loan product categories:

(1) collateral-free loans for members; and
(2) collateralised loans for non-members.

There are now five principal loan products, the interest rates of which slightly differ to the 1996 data:

(1) Business loans with a duration of 2 years, amounting to Rs. 10, 000 - 2,000,000; interest 21% effective;
(2) Industrial loans with a duration of 2 years, amounting to Rs. 100,000 - 5,000,000; interest 21% effective;
(3) Agricultural loans with a duration of 2-5 years,[3] amounting to Rs. 10,000 - 500,000; interest 15-19% effective (1996: 15%).
(4) Housing loans with a duration of 2 years, amounting to Rs. 100,000 - 3,000,000; interest 21 % effective;
(5) Hire-purchase loans with a duration of 2 years, amounting to Rs. 50,000 - 150,000. interest 12% flat or 24% effective.
Furthermore the company offers to members:
(6) Savings loans up to 50% of the savings; and fixed deposit loans on deposits amounting to Rs. 10,000 - 100,000, up to 50% of the deposits. Interest amounts to 14-17%.

Repayment modalities vary according to loan product from daily instalments to repayment in a lump sum at the end of the loan period. But interests are due at least quarterly. Delayed payment of instalments is fined with 10% on the interest. The number of delayed payments amounts to 2-3% of total loan instalments. Bad loans amount to no more than 1%.

HSFC may obtain loans from the state bank up to two years according to the finance company act.

Insurance products

In addition, HFSC offers two insurance products which automatically cover every saver-participant at no extra premium:

(1) Accident insurance up to a maximum amount p.a. of Rs. 50,000; and
(2) Health insurance up to a maximum amount p.a. of Rs. 5,000.

Organisational data

As of June 1996, the capital of HFSC amounted to Rs. 55 million. Meanwhile it has increased to Rs 100 million. HFSC is headed by a board of now nine members, three of them women. H.B. Pradhananga, the organiser-founder of HFSC, is also its chairman, and, with 80% (75% in 1996) of share-capital, its major shareholder. The remaining 20% are held by other ten persons. HFSC is largely a family affair; in this particular case, the *dhikuti* group character has not been preserved.

Now, however, HFSC has reached a size that it is restricted by law to expand its activities. As a finance company, it is allowed to mobilise savings up to ten times its share capital, and this has been achieved. Therefore, Mr. Pradhananga's plans shift into another direction. He wants to convert HFSC into a bank which mainly operates in rural areas. The legal requirement to equity capital is Rs 250 million for a bank operating in a city area and Rs 100 million in a rural area. While the latter equity is available this would mean to stop the activities in Kathmandu and other cities. Therefore, Pradhananga seeks for equity participation from a foreign bank to achieve the required capital for a city bank. Furthermore, he plans to train his staff and inform himself abroad about running a people's bank. It should be emphasised once again that within ten years only Pradhananga has been able to built up a well- functioning financial institution now ready to attain bank status which is economically viable and has a high outreach to lower income groups.

According to Mr. Pradhananga, the door-to-door service is open to fraud from the side of the collectors who might write wrong savings amounts into the savings books of those customers who cannot read or write. In the longer run he therefore wants to give up this service once he has transformed the company into a bank, and will provide grassroot-level services by second level sub-offices where people deposit their savings and obtain higher interest.

From the point of view of regional expansion Pradhananga seeks to enter the hill region where microfinance is highly underrepresented so far. Here he wisely argues from both a social as well as a businessman's point of view: people need financial services to improve their living conditions. Banks and a number of other financial institutions, however, are not represented in this region and this in turn decreases competition.

Although there are around 45 finance companies in Kathmandu alone, none of them has copied the organisational structure of HFSC which aims at people belonging to the poorer section of the population.

Exchange of experience

Is there something to be learned from that experience by similar institutions elsewhere, such as the *paluwagan* in the Philippines, the *arisan* in Indonesia, the *hui* in Vietnam and Laos? The answer to that question is not a matter of expert opinion. Blind replication would certainly not be advisable. Too much depends on the cultural background and the legal environment in each country. But if practitioners are inspired by what has happened in Nepal, we would welcome an exchange of experience, either through this journal or directly with the authors.[4]

Notes

1. *Dhikuti,* Nepali (*dhikur,* Thakali): rotating savings and credit association, now sometimes mentioned as *dhukuti.*
2. The difference between fund and bid is distributed among the members.
3. Tea and coffee plantations obtain loans for three up to five years, because the growing of the first harvest takes quite some time.
4. The authors:

Prof. H.D. Seibel
Development Research Centre, University of Cologne.
Bernhard -Feilchenfeld-Str. 11, D-50969 Koln
e-mail: seibel@uni-koeln.de

Uttam Dhakhwa
SFDP/GTZ-TA Project, Pulchowk, Lalitpur
P.O. Box 1457.
Tel.: 5-26455

Dr. Heiko Schrader
Visiting Professor, State University of St. Petersburg, Smolny,
Smolnogo Str. 1/3, Entr. 9 St. Petersburg 193060
Russian Federation
e-mail: schrader@infopro.spb.su

References

Acharya, Meena, Bishnu P. Shrestha & Hans Dieter Seibel. 1990. "Self-Help Groups in Nepal." Asia Pacific Rural Finance (Bangkok) Vol. 1, No. 1, 1988: 3-6;

Acharya, Meena, Bishnu P. Shrestha & Hans Dieter Seibel. 1990. Promotion of Linkages Between Banks and Self-Help Groups in Nepal. *APRACA*, Bangkok.

Bista, D.B. 1971. "The Political Innovators of Upper Kali Gandaki." *Man* 6:1.

Bajracharya, Bodhi Bajra. 1995. *"Dhukuti System: A Preliminary Study."* Unpublished report submitted to GTZ- SFDP, Kathmandu.

Bouman, F.J.A. 1994. "ROSCA and ASCRA: Beyond the Financial Landscape." In F.J. Bouman and 0. Hospes (eds.): *Financial Landscapes Reconstructed. The Fine Art of Mapping Development.* Boulder: Westview.

Dolebel, T.C. 1985. "Dhikuti Associations in the Western Hills of Nepal: A Case Study of Bhumdi Village." *The Economic Journal of Nepal* 8:4, Issue 32: 13-20.

Fürer-Haimendorff, C.Von. 1975: *Himalayan Traders.* London: Murray.

Seibel, B.O. and Bishnu P. Shrestha. 1988. *Dhikuti: The Small Businessman's Informal Self-Help Bank in Nepal. Savings and Development (Milan)* Vol. 12 No. 2, 1988: 183-200

Seibel, H.D. and U. Dhakhwa. 1997. From *Informal to Formal Microfinance: The Transformation of the Dhikuti in Nepal* Asia Pacific Rural Finance, April-December, pp. 99- 101.

Schrader, H. 1988. Trading Patterns in the Nepal Himalayas. Saarbrucken and Fort Lauderdale: Breitenbach Publishers.

Schrader, H. 1991. Rotating Savings and Credit Associations - Institutions in the, Middle Rung" of Development? Wp. No. 148, Sociology of Development Research Centre, University of Bielefeld.

Von der Heide, S. 1985. Die Thakali aus Thak Khola im Nordwesten Nepals. M.A.-Arbeit. Freiburg i.Brsg.