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NEPAL CASE STUDY: ADAPTING APPROACHES AND PRODUCTS TO PERSEVERE DURING CONFLICT

AMAP KG ECONOMIC RECOVERY AMID CONFLICT CASE STUDIES

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DISCLAIMER

The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

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INTRODUCTION TO THE CASE STUDY

Globally, sound and inclusive microfinance has demonstrated its ability to contribute significantly to poverty reduction, provided that microfinance institutions (MFIs) adhere to a double bottom line approach of delivering sustainable financial services to the poorest segments of society.

In some countries affected by long-running conflict, microfinance has been seen to persevere and even increase outreach (e.g. in Nepal) while in others (e.g. Palestine) the industry has fared less well.

As no microfinance model remains 'best' as environments change, the success of MFIs in conflict-affected countries often hinges on their willingness and ability to adapt management systems, operations and products to respond effectively to changing client needs and political evolutions.

AMAP KG

USAID's Accelerated Microfinance Advancement Project (AMAP) Knowledge Generation (KG) research on Microfinance Amid Conflict[1] began in 2003 with a focus on identifying best practices among MFIs in conflict countries. This was later expanded to examine particular populations impacted by war. During the last two years of the project, the role of microfinance within the broader economic recovery efforts after conflict has been a focus area. Economic recovery is a broad umbrella of activities comprising the full array of programming with an economic objective.

As part of the economic recovery agenda, the AMAP KG team conducted a series of workshops with practitioners and donors working in conflict affected countries. The workshops concluded that there were undocumented examples from the field which could provide valuable lessons to the larger community. To provide a better understanding of how microfinance institutions can contribute to economic recovery efforts, AMAP KG issued a call for nominations of case studies. The Nirdhan Uttham Bank Limited (NUBL) in Nepal was selected for profiling.

This MicroReport provides a brief background to the country context for microfinance development in Nepal before presenting the transformation of NUBL from a community-based NGO to a licensed development bank with 50 branches. The Report examines the responses of NUBL to the threats and the impact on the Bank of the conflict in Nepal and concludes with a summary of lessons learned to date. Researched independently, the findings of the Report are consistent with those of a USAID Nepal Note from the Field[2] written by Save the Children and published in March 2008. This Report seeks to avail NUBL's experience to a broader audience as NUBL offers important pointers for risk mitigation in a conflict-affected environment and lessons learned on how adaptation of strategies, delivery mechanisms and product characteristics can help microfinance providers ride the waves of societal conflict.

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[1] See www.microlinks.org for more information to this research.
[2] See http://www.microlinks.org/ev_en.php?ID=22208_201&ID2=DO_TOPIC

BACKGROUND ON NEPAL

Sandwiched between India and China, the multi-ethnic country of Nepal ranks 138th on UNDPs human development index. Some 31% of the population of 25.3 million growing at a rate of 2.3% per year, lives in extreme poverty[3] and around 90% of the poor survives on subsistence agriculture in the hilly and mountainous rural areas. After promising economic reforms and progress in the 1980s, the country experienced stagnation in the 1990s and steady decline since 2000 when general political turmoil was exacerbated by a constitutional crisis. A lot of hopes were pinned on the April 10, 2008 Constituency Assembly election which was charged with writing a new constitution, and in the process abolished the century old monarchy in the country.

The 10-year violent conflict between the Nepalese government and the militant Communist Party (Maoist) – often termed the Maoist insurgency - dramatically affected the country's socio-economic fabric at both the macro and micro levels. The closely interrelated root causes of the conflict are widely viewed to be a mix of inequitable social-economic and political access, poor governance/corruption and poverty. Since the beginning of the insurgency, the conflict has claimed the lives of more than 13,000 Maoists, security personnel and civilians. Additionally, there have been numerous abductions and other human rights violations perpetrated by both the Maoists and the government Security Forces. The economic costs of the conflict are estimated to be around 8-10% of Nepal's Gross Domestic Product (GDP).[4]

During the period of active insurgency (2000 – 2006) the government of Nepal effectively lost control of large swaths of rural Nepal, and the Maoist rebels set up a parallel administration and taxation system in the areas under their control. Frequent strikes, road blocks and violent attacks closed down markets and transportation systems and severely affected the entire economy, including microfinance, non-financial business development services, NGO development work and private business. Ordinary people were trapped between the conflicting parties. Especially in rural areas the warring parties pressed the population for support. As a consequence the number of internally displaced persons increased significantly; many young people joined the government Security Forces or the Maoist army to earn a living; others migrated to the cities or left the country. The volume of remittances from overseas workers (mostly in India, Arab countries and Malaysia) jumped 580% to US$ 808 million in 2004, or 14% of GDP. 25% of all Nepalese households receive remittances. However, very poor households are rarely amongst those that benefit.

The financial sector of Nepal is dominated by two state-owned commercial banks, but reforms are ongoing to privatize the sector. The mushrooming financial sector (see Table 1) is regulated by a multitude of laws and regulations by the central bank (Nepal Rastra Bank, NRB) to provide banking services to various extents.[5] Nevertheless, the sector remains characterized by heavy government ownership and intervention with direction of credit and until very recently also controlled interest rates, high non-performing assets, and weak corporate governance, regulation and supervision.

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[3] 2005 projections of the Nepal Living Standard Survey (NLSS) 2003/04 and Informal Sector Research and Study Center, 2004.
[4] GtZ: Rural Finance in Conflict Environments – Experience from Nepal's Small Farmers Cooperatives Limited (SFCL), December 2005.
[5] Nepal Rastra Bank: Quarterly Economic Bulletin, October 2007.

Table 1: Overview of the Financial Sector in Nepal

Type of Financial Institutions	Number (as of April 2008)
Commercial banks (private joint-venture and state-owned)	23
Development banks	58
Regional State-owned Rural Development Banks	5
Private Microfinance development banks (including NUBL)	6
Finance companies (Non-bank Financial Institutions)	79
Postal savings bank	1
Savings and Credit Cooperatives (regulated)	17
Financial Intermediary NGOs (licensed)	47

The banking sector with its exposed branch network in the rural areas has been a prime target of the Maoist insurgency. An estimated 20-30% of the branch network of the three largest banks has been looted and vandalized by the Maoists, ultimately resulting in the withdrawal of banking services from the rural areas. The Maoist rebels also attacked microfinance institutions (MFIs) and forced many to reduce their interest rates and encouraged their clients to stop paying back loans. MFIs seen as having links to foreign donors and/or the government were particularly targeted, whereas community based and especially women-owned savings and credit cooperatives, and informal savings and credit groups were in general not attacked. Based on their communist ideology the Maoist insurgents seem to have taken a "soft approach" towards those MFIs which they perceive as not-for-profit, people-owned, non-exploitative and not affiliated with the government.

Despite the conflict and the inherent development challenges of the country, however, it is important to note that the overall growth in credit and deposits in the financial system of Nepal has remained positive throughout the conflict. Today, over 3,600 registered microfinance institutions provide credit, savings and insurance services to 1.25 million customers of whom an impressive 73% are women.[6] While the current outreach only covers 26% of the estimated minimum market for microfinance services of 8.6 million people,[7] it is noteworthy that also microfinance in Nepal has demonstrated a continued annual growth in the face of conflict. By examining the adaptation strategies of Nirdhan Uttham Bank Limited during the active insurgency, this Report aims to uncover options for conflict-induced risk mitigation that may be of relevance to MFIs elsewhere.

NIRDHAN UTTHAM BANK

PROJECT DESCRIPTION

Nirdhan was founded and registered in April 1991 as a micro-lending NGO with the sole objective of poverty reduction, inspired by Grameen in Bangladesh. Two years later, Nirdhan had raised funds and hired two staff and issued its first micro-loan in the Rupandehi district of South-West Nepal. With the enactment of the Development Bank Act in 1996, Nirdhan was the first NGO to transfer its microfinance operation to an autonomous microfinance development bank - Nirdhan Uttham Bank Limited (NUBL), enabling it to mobilize voluntary savings. The NGO Nirdhan remained and focuses on non-financial services such as training and business development services for the poor.

In 2007, NUBL was licensed by the Central Bank as a "Class D Microfinance Development Bank" ("Bank for the Upliftment of the Poor") under the Bank and Financial Institutions Act. The Bank has maintained its focus on the poor and low-income population of the Terai lowlands and more recently in the Middle hills of Nepal, and aims to

[6] The State of Microfinance – Depth and Breath, Center for Microfinance, Nepal, Feb 2008 (figures as at January 2008).
[7] Calculated by the Center for Microfinance as the total population living below the poverty line x 1.5.

expand even further. Recently, the Bank initiated the establishment of Nirdhan Uttham (India) in Uttar Pradesh, availing financial services to clients on the other side of the Nepali-Indian border.

The NGO Nirdhan is offering vocational training for clients of the Nirdhan Uttham Bank.

As a Grameen-replicator, NUBL provides credit, savings, microinsurance and money transfer services exclusively to women. The core product of NUBL is the Grameen-type group loan (individual loans with solidarity group guarantee). Individual loans with physical collateral are also provided. Loans are available for general enterprise purposes, seasonal agriculture and business (with bulk repayments), and non income-generating consumption, such as tube-wells, sanitation, housing, foreign employment, biogas, education and emergencies.

The maximum loan size for collateral free group loans is $952 while collateralized loans can go up to $2,380. The average effective interest rate is now 20% p.a. calculated on a declining basis, down from a 25% effective rate (12.5% flat) in 2002. Mandatory savings are collected from group members and NUBL has a self-managed personal savings program where funds can be withdrawn at will. Both savings products attract a generous interest of 6% p.a.. NUBL's micro insurance products were recently introduced, and include a self-insured term life/accident "Micro Security Fund" for borrowers which can be extended at an additional cost to the clients' spouse and parents, as well as livestock insurance offered in partnership with a governmental insurer. The Bank offers money transfer services as a sub-agent for a commercial bank linked to Western Union as well as for local remittance companies.

RESPONDING TO THE CHALLENGES OF A CONFLICT ENVIRONMENT

Up until mid 2000, NUBL had every reason to be satisfied with its development. While not fully financially sustainable, the portfolio of loans and savings was almost doubling year-on-year reaching 31,400 savers and 26,600 borrowers, and arrears were kept below 1%. NUBL grew organically based on an expansive and client-focused business plan, but had, however, become an insular MFI, interacting little with its environment until the effects of the Maoist insurgency intruded.

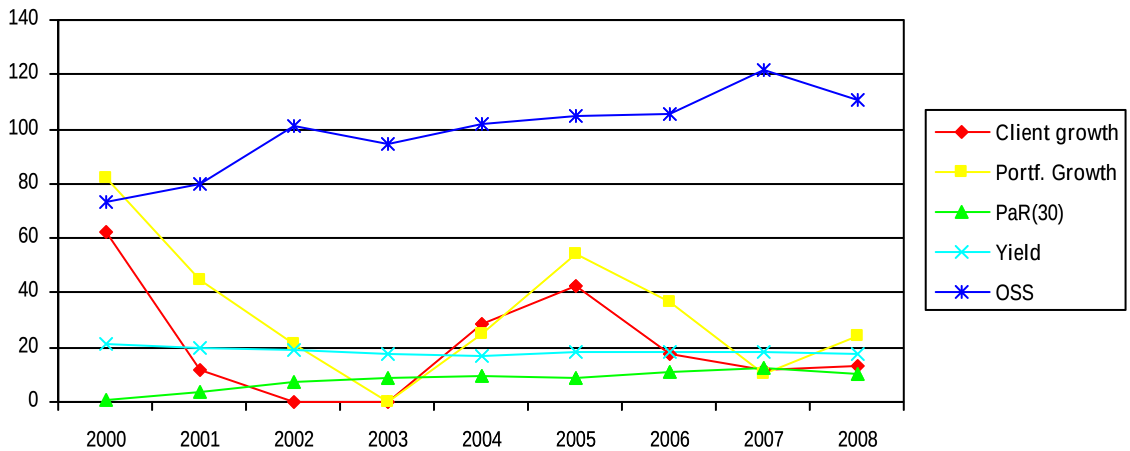
During 2000-2003 NUBL experienced stagnation in the growth of its client outreach and loan portfolio, and a surge in loan arrears and losses. The key reasons were the public criticism and pressure exerted by Maoists on clients to stop repayments (and borrowing in general) as well as increasing incidences of theft of cash from loan officers and branch offices, two of which were attacked in 2007. The attacks were accompanied by Maoist allegations that Nirdhan was an 'imperialist agent' receiving free funds from abroad and lending it to the poor at usury rates. Grameen replicators like NUBL were also criticized for their modality of direct lending to clients, lack of client ownership, and over-emphasis on commercial (usury) credit services.

Eight years later, the insurgency has abated and new elections have been conducted with the Maoists as a leading political party. NUBL has emerged from the crisis still strong, although not unscathed. It has built a firm foundation of market-responsive service delivery to its core clientele as a key market player with 91,200 savers and 66,280 loans outstanding in a portfolio of US$ 11.2 million as of April 2008. The lessons learned from the process are many and important to MFIs in similar situations and are presented below.

STEP 1: MONITORING TRENDS TO ANTICIPATE PROBLEMS

Had NUBL only looked at absolute portfolio figures, the crisis would not have been immediately apparent. The bank lost only a few hundred borrowers and savers per year during 2001-2003, and the value of the loan outstanding portfolio outstanding dipped only during 2002-03, where after it grew again. Net savings mobilized grew year-on-year. But NUBL also tracked and analyzed key growth ratios. The trends in client and portfolio growth rates triggered alarms. This early realization that something was seriously wrong gave the Bank a head start for mitigating the risks before they grew out of hand.

Figure 1: The Warning signs: NUBL ratios 2000-2008 (%)



STEP 2: MODIFYING AND ADAPTING DESIGN AND OPERATIONS

Having realized the problem, the first and possibly most important strategic decision taken by the Bank management and Board in the face of its first and most severe crisis ever was to manage and mitigate it - engage and persevere rather than withdraw, as many other financial services providers felt compelled to do. NUBL wanted to remain in the market place, keep branches open, and continue disbursements and service development. However, to do this in the face of direct criticism and occasional violent attacks required the Bank to embrace market-research and a strategy of interactive communication with the stakeholders in the general public whose influence had not been sufficiently recognized in the past. In addition to managing up (donors) and down (clients), NUBL had to learn to also manage 'around', i.e. interact with local government and Maoist authorities and the local communities at large. Looking back, says General Manager Mr. Prakash Raj Sharma who joined NUBL in 2000, "the conflict environment provided a crude but extremely efficient wake-up call to our slightly complacent and self-sufficient Bank, acting as a catalyst for change – we realized that we had to act and now we can reap the positive benefits".

Center Meeting in Godaha, Rupandehi.

The center leader Sima, who has a loan of Rs. 40,000 (US$ 635) has been with NUBL for ten years. She and other group members recall that in the beginning of the conflict they were very scared. Says Sima: "We were more afraid when the helicopters swarmed overhead and the police searched the village for rebels. It was difficult when the roads were blocked and there were strikes". Manmaya who has a loan of Rs. 30,000 (US$ 475) for buffalo rearing and milk production agrees: "Sometimes we had to pour out the milk, because we couldn't take it to market and the prices we got selling here in the village were too low".

The core threats to the Bank were the persistent and very public calling into question of its objectives, delivery mechanisms and impact on the poor that it claimed to serve, and the direct physical attacks on its key assets: staff and office infrastructure. In a prolonged and often difficult process, the Bank critically reviewed its policies, procedures, products, pricing and services to identify adaptations that would reduce the immediate security risks and gain the trust and support it sorely needed from clients and the public at large – NUBL became a learning organization. The main results of this process are presented in Table 2 below. As an example of some of these process changes, NUBL increased its communication with clients and the public at large in response to the verbal attacks it received. It became active in relaying information during local rallies, to public officials, and to use the media in such a way as to increase its transparency and gain support. Most significantly, it reduced its interest rate and increased its socially responsible activities, like support to child scholarships.

BANKING DURING CONFLICT: NUBL KOLBHI BRANCH

Established in 1999, the NUBL branch in Kolbhi lies in 'Maoist heartland' in the Midwest. By 2003, a propaganda campaign and frequent clashes between Maoists and the government had left the 1,700 clients too afraid to venture out, let alone associate with the 'imperialist agent' bank in their village. The only two other bank branches in Kolbhi closed. NUBL repayments faltered and there were no new loan applications. NUBL staff had received several threats. One day five loan officers were intercepted by rebels and their cash and bicycles were stolen. The branch realized they could not continue visiting clients, and asked clients to come to the office to repay loans, offering a 2% discount on the interest. One week later, ten rebels attacked the office.

Former branch manager Mr. Kashi Ram Bhattarai remembers: "They held a *khukuri* knife to my neck, broke open our safe and took all our cash. They stole the printer and monitor, and threw our files and computer on a fire outside. We couldn't continue". Mr. Bhattarai publicly announced the suspension of the Bank's services. However, all staff remained in the village and when meeting clients explained that they were willing to open for business as soon as the threats ceased. In the subsequent six months, clients realized that they were left without any financial service provider. They engaged directly with the Maoist local cadres, complained of their loss of access to finance and demanded that services resume. Eventually clients requested NUBL to reopen the branch, and since then the branch has been left in peace. Today, Kolbhi branch has 4,545 savers and a portfolio of US$ 0.5 million in 3,313 loans. Arrears are still among NUBL's highest at 29.5% PaR, but repayments have resumed and clients are depositing savings again.

Table 2: Summary of NUBL's risk management and mitigation strategies

Threat 1:	Insecure Environment Clients' MEs in general not directly targeted, but affected by violence, strikes & road blocks (restriction of movement of persons/goods, input price hikes)
	Impact on NUBL: - Initial emphasis on collateralized loans proved ineffective – many loans defaulted - Arrears increased steadily year-on-year - Clients withdrew savings (2006) and borrowed from friends/family/money lenders
	Adaptation: "Stand fast" mode - Strategic decision to continue lending, and not close any office - Instituted market-research, client and staff feedback loops and increased flexibility in implementing Grameen model - Loan loss reserves were increased
	Effects: - Increased client loyalty and benefit from decreased competition (bank branch closures) - Increased staff loyalty and participation, better market information, clearer input to adaptation process - Gradual change from rigid Grameen replicator to learning organization
Threat 2:	Direct criticism Criticism of NUBL as profit-driven 'commercial' bank only – not providing services to the people. NUBL declared unwanted in some districts. Maoists encouraged and coerced clients not to attend meetings, not to take loans or repay loans. Clients in some areas sympathetic to ideology of Maoists
	Effect on NUBL: - Growth in number of clients and value of portfolio stagnated - Arrears soared, loan losses increased - Client drop-out rates increased
	Adaptions: 1. Increased visibility and communication - Participation in political rallies and meetings with local opinion makers to counter allegations - NUBL brochure in Nepali with FAQs disseminated; journalists hired to study and write about NUBL - Documentation of interest structure to local officials; focus on 'social responsibilities' (child scholarships) 2. Revision of pricing - Loan interest cut and changed from 12.5% flat to 20% declining - Revision of 5% up-front compulsory savings on each loan to10% of outstanding balance, or Rs. 500 - 2% discount on interest balance at repayment 3. Delegation of authority to front line staff - Allowed branches to change loan repayment schedule from weekly to bi-weekly and to reschedule loans - Responded to market demands for 'credit+' and non-income generation loans with community benefits - Instituted staff incentive scheme 4. Add-on insurance - Converted "Emergency Group Fund" into internal Micro Security Fund with better claims management
	Effects: Gradual and localized accept and support among local decision makers/ insurgents; gradually less 'usury' allegations and critique - Less deposit mobilization but increased client satisfaction; portfolio yield remained constant at around 18% - Increased staff and client loyalty - Decreased portfolio risk in cases of violent death/injury
Threat 3:	Directs threats and violence: Physical attacks on/theft from staff and looting and torching of branch offices
	Impact on NUBL: - Fearful staff with lower productivity - Cash losses - Disruption of operations, data and equipment lost
	Adaptations: 1. Cash management to reduce risk - At group meetings, collected repayments were immediately re-disbursed as loans - Retreat from door step banking: clients were encouraged to repay at branch office 2 Enhanced back-up procedures - PCs relocated from offices under threat - Duplicate of all loan agreements kept at area office; and weekly back-up and off-site storage of all data 3. Better security awareness/procedures - Evacuation of threatened offices/staff to safe areas - Branches encouraged to take relevant security measures (e.g. suspension of services)
	Effects: - Rapid disbursements increased client loyalty - Risk transferred from staff to (insured) clients but less follow-up and hence negative effect on arrears - Initial data loss strengthened back-up systems; client obligations remained documentable; and actual asset loss remained minimal Temporary closures led to clients requesting reopening and providing support

STEP 3: DEVELOPING A COMMUNITY-BASED MODEL

The combined effect of increasing competition; a visionary drive to expand from the bank's heartland in the Terai to the hills and more remote areas of the country; and the Maoist allegations of inadequate community ownership and benefit drove the Bank to rethink the Grameen model faithfully replicated since inception.

NUBL has designed a microfinance delivery mechanism that features community (client) ownership while mitigating risks of misuse of resources, being cost-effective, and having a chance of reaching sustainability in the remote, sparsely populated and inaccessible hills and mountains of Nepal. With support from its strategic partners Plan Nepal and Save the Children US, the Bank piloted the Self-Reliant Group (SRG) model in the Terai lowlands (Banke district) in 2003 and then in the hills (Palpa District) in 2004. As of January 2008, 7 of the Bank's 50 branch offices are operating the SRG model, under which 492 Groups have been mobilized, benefiting 14,134 clients or nearly 16% of the total clientele of NUBL.[8]

The SRG model is essentially a hybrid of Village Banking and Grameen group lending. It incorporates the targeted client selection based on Grameen-like criteria but without the restrictions on group size. The 3-6 month group mobilization and savings process common to both models follows, and Bank staff facilitates group leadership election, training and capacity building, including the provision of standardized systems and tools for loan and savings management, recording and reporting. The SRG model emphasizes the Village Banking aspects of full group ownership and management (as opposed to Grameen facilitation by loan officers), and the subsequent external funding to ensure sufficient loan capital, and adds the annual profit sharing among SRG members known from Rotating Saving and Credit Associations (ROSCAs).

The model ensures client access to the whole range of NUBL services, with the SRG managing and approving the collateral-free (group-guaranteed) loans and savings using passbooks, whereas individual loans, insurance and remittance services are provided directly by a NUBL branch within a 10-15 km radius of all SRGs in a given area. The branch also provides regular monitoring and supervision, which is seen as crucial to avoid misuse of funds. After 3-6 months, SRGs can access wholesale loans from NUBL at a value of up to 20 times of their group savings at an annual interest rate of 18% (declining balance). The bank refunds 3% of the interest during the annual closing of SRG books, if the SRG pays back on time. The SRG sets its own internal interest rates.

The gradual introduction and field-testing of the model proved important to NUBL. Several aspects of the model were adapted and modified from the first pilot district to the next and in its new 'learning mode' NUBL continues to adjust and improve the model based on results in the field. On the positive side, none of the SRGs to date have registered any loan defaults, and the model met with Maoist approval and support and hence no SRG has been affected by insurgent attacks or pressure. The key concern, however, remains the question of model sustainability.

Low and slow growth of outreach (20-23% in year 2 as opposed to 75-80% in the Grameen model implemented by NUBL in the populous Terai), small loan sizes (commensurate with the limited business opportunities for clients in the remote hilly villages), as well as low interest rates set by the SRGs are obstacles to the supervisory NUBL branches not earning sufficient income to cover operational costs. Some of these constraints were unintentionally caused by cautious Bank policies set for the SRGs (e.g. restricted growth rates, limitation of loans per client etc.), which have since been revised, and the more recently established SRG-branches are growing faster and costing less per client than the older ones, but the difficult demographic and topological environment of Central Nepal present inherent problems for sustainable microfinance operations.

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[8] Dr. Harihar Dev Pant, Prakash Raj Sharma and Prabin Kumar Dahal: Reaching Groups of Remote Areas with Microfinance Services - A case study of the Self-Reliant Group (SRG) Model. A Paper presented by NUBL to the Microfinance Summit Nepal 2008, February 2008.

In general, the NUBL SRGs lend to the members at an interest rate of 24% (declining) p.a., providing a spread for the groups of around 9% (assuming on-time repayment and hence the 3% discount on the external loan). This appears sufficient to cover basic operating and financing costs, loan loss provisioning, and leaves a little for distribution of dividends to group members at the end of each fiscal year (NUBL SRG members received Rs. 400-600 ($6-9) in dividends at the end of FY07/08.

However, the supervision required in the model necessitates the establishment of NUBL branches within reasonable proximity of groups. As profit centers, the branches receive a net of 15% interest income from wholesaling funds to their SRGs (assuming on-time repayment). The branches pay 8% interest on borrowed funds from NUBL and must allocate at least 1% as a loan loss provision expense, leaving only 6% interest income to cover administrative costs.

Faster growth targets and a recall of the generous discount for on-time repayment by SRGs would allow the youngest SRG-branch of NUBL to cover total operational expenses by the end of its 4th year of operation. The investment costs of NUBL (losses) during this period will have amounted to Rs. 2.6 million ($41,300) for the provision of microfinance services to around 1,300 households.

LESSONS LEARNED:

NUBL has emerged from the biggest challenge in its history somewhat skinned, but as a more flexible, more market-oriented and more innovative MFI. While the lessons learned on the way have been harsh there is little doubt that the Bank can look more confidently to the future, able now to remain alert to changes and new risks in its environment that will require new mitigation and management measures. Key lessons learned from which MFIs in similar circumstances may benefit include:

- **Early Warming Systems are crucial**: Realizing that there is a problem early on is tantamount to winning half the battle. In NUBL's case, a simple spreadsheet of key growth ratios updated on an annual basis alerted the Bank to serious problems before they were detectable from the absolute portfolio figures. All too often MFIs record and report ratios for the sake of pleasing donors or Boards of Directors but overlook the importance of these ratios as monitoring systems. Tracking and trend analysis of ratios enable MFIs to identify, assess the frequency and impact of, and prioritize risks. Over time, 'risk drivers' can be determined (e.g. client and portfolio growth) and monitored. By assigning thresholds for risk tolerance and appointing 'risk owners' i.e. senior staff responsible for risk monitoring, MFIs would have an effective early warning system, and thus more time to develop strategies to effectively manage and mitigate the identified risks.
- **Staying put Increases Client Loyalty:** It is important not to give up and withdraw in the face of conflict. During conflict, both clients and microfinance institutions suffer. All too often, however, MFIs focus on the immediate risk to the institution and suspend disbursements, close branches and wait for the storm to pass. This approach leaves clients stranded and thus negates the very foundation on which non-collateralized microfinance rests: the chief client motivation for repaying a loan is the promise of future access to more and larger loans. If this trust bond is broken, it is difficult to build client loyalty. The key to successful microfinance lies in the ability to cost-effectively reach and retain a critical mass of clients with systems of delivery, market responsiveness, risk management and controls that can ensure the long-term survival of the institution, i.e. the continuous provision of services. Standing by clients during hard times helps build the foundation for sustainability.
- **Risk Management and Mitigation is an Ongoing Process:** The turn-around of NUBLs organizational culture from introvertly assuming market knowledge to responsively interacting with its environment is possibly the most important achievement of the Bank during this difficult decade. Ironically, the conflict that nearly caused the institution to falter was a catalyst for this change. For NUBL as for any MFI in a similar situation, adopting a 'learning mode' of continuously improving service delivery through adjustments, adaptations and modifications can not

only resolve immediate problems but can become a motivational tool. No microfinance model remains 'best' as environments change, and incremental adjustments confirm the willingness of the MFI to respond appropriately to clients, investors and other stakeholders alike.

- **In Challenging Environments Community-based Models have Merit:** Many MFIs in Nepal have experimented with delivery service models to sustainably serve communities in the sparsely populated and inaccessible hills and mountains. As documented in Nepal, the development of empowering community-owned and managed financial services models also has merit in political conflicts when externally driven support to communities is questioned. But there are necessary trade-offs between outreach, costs, and controls.
- **Communities need both Financial and Non-financial Services:** Poor, rural communities with limited economic activities and market opportunities need to be brought into mainstream value chains in order to build assets and increase incomes and microfinance cannot do this alone. A more integrated approach including basic and business literacy, skills development and access to market input and outlets is necessary, but microfinance remains an important part of the array of services that such communities need.

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