



Mini Review

Challenges and Opportunities of Microfinance in Nepal

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Abstract

The purpose of the paper is to highlight the opportunities and challenges face the microfinance sector in Nepal. Many developmental programs implemented in Nepal, microfinance programs have a strong rural oriented and targeted the poor, specially for women. Numerous challenges are ahead of this sector like lack of accessibility, unhealthy competition, seasonal migration, political unawareness, excluding vulnerable groups, threatening the financial discipline, resource constraints, low level knowledge of microfinance institutions (MFIs) etc. On the other hand, existing in poverty in Nepal, along with opportunities, is paving way for the growth of this sector and offering a huge market potential for microfinance. On this basis the sector presents a lot of opportunities such as: stimulating growth of economy, women empowerment, increasing volume, accessibility and outreach, economics of scope etc.

Keywords: Poverty; Microfinance; Challenges; Opportunities

Introduction

Microfinance is the provision of financial services to low-income clients, including consumers and the self-employed, who traditionally lack access to banking and related services. More broadly, it is a movement whose object is “a world in which as many poor and near-poor households as possible have permanent access to an appropriate range of high quality financial services, including not just credit but also savings, insurance, and fund transfers”. Those who promote microfinance generally believe that such access will help poor people out of poverty.

The vision of microfinance is quite simple to create systemic change in financial systems Worldwide. Instead of the exclusive financial systems that have for decades benefited and protected the wealthy, microfinance intends

that they serve the impoverished majorities, help lift them out of poverty, and make them full participants in their country's social and economic development.

The microfinance revolution began when Bangladeshi economist professor Muhammad Yunus first handed over a few dollars to an impoverished basket weaver in 1974. Since then, the movement toward microfinance. The granting of very small loans to the poorest people in the world to enable them to run small businesses that will lift them out of poverty. Has won passionate supporters across the globe. Last year, Yunus and the microfinance institution the founded, *Grameen* Bank, shared the Nobel Peace Prize.

It is well-recognized fact that microfinance is the most suitable way to empower the poor and to increase their

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income generating capacity. In Nepal microfinance as a tool to eliminate poverty is well accepted.

The basic idea of micro-finance services is to provide the financial assistance to the poor at the time he or she needs it at the doorstep and at a very convenient condition. Recently microfinance has special attention not only in the academic debates but also in the area of policymaking (Smailbone and Wyer, 2000).

Microfinance is a simple but effective credit tool that enables the most poor to pull themselves out of poverty. It involves advancing small loans to the working poor. These loans are usually less than \$200 and made by local organizations called microfinance institutions (MFIs). Microfinance helps the working poor to establish or expand small businesses that generate additional income for the family use. This extra income allows a poor family to buy food, access healthcare, educate their children, put aside savings and lay the foundation for a better future. Microfinance is one of the best alternatives to generate self-employment. It provides services to the communities who have no collateral to offer against the loans they take but have indigenous skills and strong desire to undertake economic activities for self-employment and income generation (Shrestha, 2009).

Microfinance institutes are giving loan facilities to women for establishing their own source of income. 62% women used that loan for starting their own business and remaining 38% use that for different purposes. Women feel hesitation to start their new business because Micro Finance Institutes are not providing required training to these women and this is major reason for this (Mahmood, 2011).

Living standard is very important issue in all developing countries. In many developing countries like Bangladesh, Pakistan, India and Nepal microfinance is now using as a tool to increase the living standard of poor community. There is positive impact of micro financing on income level and better services of microfinance institutes increase satisfaction level of customer (Akram and Hussain, 2011).

Microfinance sector required innovative ideas beyond traditional financial system. Social intermediation increase human capability and group base lending schemes reduce processing cost and decrease financial risk in relation to providing credit to poor. Micro financing is the tool to decrease financial cost and expenses in an efficient way (Dusuki, 2008).

Different factors have significant effect on low loan recovery rate. These factors include borrower's wrong attitude repayment, microfinance institute staff's weak skill, corrupt tendency and poor infrastructural provision by the government. These factors has a direct impact on NPLSs (nonpayment loans) and on micro credit services (Anayo, 2011).

Unproductive use of human resources, financial and other resource are root cause of poverty. Poverty has multi dimensions and persists due to this reason. Major hurdles in improving living standard are lack of financing. So poor don't take any part in the economic development activities due to the lack of credit for improving their standard of livings. Microfinance services by Microfinance institutes such as savings and micro loans have direct impact on GDP (Gross Domestic product). An organized support to the microfinance is necessary to start soothing trend for poverty alleviation and economic growth (Awojobi and Bein, 2011).

INAFI SAP-Nepal (2004) Microfinance enabled the poor to enhance their access to financing for income growth and welfare improvement through micro-enterprise development and increased ability to address vulnerability and economic empowerment; Microcredit was used for production (66%) and the remaining for consumption. Microfinance contributed to reduce poverty in client households. Respondents increased their incomes by 56 percent after participation in the microfinance programs. Beneficiaries have increased slightly more financial, physical and human capital than non-clients; Microcredit has served to lessen their dependency on moneylenders, reducing the average interest rate burden especially for the poor; Microcredit has promoted micro-enterprise activities, which in turn have increased wage and self-employment opportunities for the beneficiaries and the community people. There is great need to expand the MFIs in high hills and mountains, where the majority of poor lives.

Objectives

The main objective of the study is microfinance position and the analyze the opportunity and challenge faced by microfinance sector in Nepal

Microfinance in Nepal

The microfinance sector was served by cooperatives (1950-1960s) and normal banks (1970-1980s) until 1980, when a number of pilot projects and initiatives were implemented to introduce the financial and banking services to help poor and women. However, few groups of poor people were benefited, but at the end these service were found ineffective. It was recognized as an official poverty alleviation tool only in the country's Sixth Plan (1980/81-1984/85).

During the 1990s and early 2000s, the sector has, however, gained momentum after the restoration of democracy in 1991. the government moved further to strengthen the Microfinance Institutions to provide financial service to poor and women, with the formation of five Regional Development Banks (RDBs) in each Development region based of *Grameen* model with the sole objective to provide micro-credit services to the poor and women. Eventually these Regional Development Banks transformed to

Microfinance Development Banks (MFDBs) after privatization and licensed as class 'D' financial Institutions.

During early 2000s, a number of private microfinance and NGOs came into existence with microfinance programs. Under *Grameen* Model, NGOs such as Nirdhan Utthan Bank, Center for Self-help Development (CDF) successfully implemented microfinance program and later transformed to Microfinance Development Banks. Similarly other Microfinance Development Banks, Chhimek Bikas Bank Ltd. (CBB), Depros Bikas Bank (DBB) and Nerude Microfinance Development Bank Ltd. (NMDB), were also formed. NGOs which were involved in community based financial activities were also legalized and licensed by Nepal Rastra Bank (NRB) to formalize micro financing services, as a result Financial Intermediary NGOs (FINGOs) were formed. Now, Nepal has a wide variety of active microfinance institutions that provide financial services to the poor.

Challenges

Microfinance is now globally recognized as an effective tool for reducing poverty. It has shown positive results in many countries; however, microfinance services have not yet deepened down to reach the neediest poor. There are still huge masses of people deprived of financial service in Nepal as in a number of other developing countries. At the same time, there are a number of challenges facing the microfinance Industry in Nepal. They are discussed below:

Lack of accessibility

Rural and remote areas, where most of the poor population reside, have limited physical infrastructure and economic opportunities for the people. Microfinance operations cannot flourish in such areas. The government should get involved to actively develop the basic infrastructure required for improving agriculture and local economy.

Unhealthy competition

Lack of supporting environment and less of coordination between government agencies and micro finance banks/institutions, number of instances where duplications in the working area. In limited areas where more institutions work with the same clients.

Seasonal migration

A large number of people from rural and remote areas migrate to towns and urban areas for seasonal employment. They need access to microcredit, but MFIs are hesitant to extend services to them due to their temporary nature of stay in the program areas.

Political unawareness

Most political parties and leaders are unaware of the basics of microfinance and the need of institutional sustainability of MFIs, seeing microfinance programs as charity. Occasionally, they have argued for lower interest rates and loan waivers.

Excluding vulnerable groups

The ultra-poor, the marginalized castes (dalits and janjatis) and the destitute are still excluded by the existing microfinance programs even in the Tarai regions where microfinance programs are concentrated. MFIs need to focus on their services to these vulnerable groups urgently.

Threatening the financial discipline

Highly subsidized microcredit programs are still being operated in most parts of the country, which have been threatening the financial discipline and basic norms of microfinance systems.

Resource Constraints

According to the direction of NRB, Commercial banks, development banks and finance companies has to provide deprived sector loan 3 percent, 2 percent and 1.5 percent of their transaction to MFIs but credit on micro hydro, hospital, youth for employment and small housing is countable in microfinance which is almost half of the resource altered for MFIs. MF Banks are expanding areas in villages and unreached districts but resources are going to be limited. NRB and Government should deeply initiate to the fact that 3 percent deprived sector loan must be available to MFIs.

Low Level of Knowledge

The working and efficiency of banking sector as well as MFIs largely depends upon the quality of human resources, operating system procedure and practice and the level of knowledge of the person who are responsible to run that system. Unfortunately, existing human resource has a very low knowledge level which is quite insufficient to run this mechanism smoothly. It is another big challenge for the MFIs in Nepal.

Opportunities

Poverty Alleviation

Poverty is one of the major problems of the world at this juncture. Of course, Nepal is not an exception to it. It is proven that poverty can be reduced from microfinance. It is also admitted that role of microfinance is not just restricted to poverty alleviation but it also diversifies income-carrying sources, builds assets and improves the status of women. It has a positive impact on income and assets levels (Greetha, 2006).

Conducive legal environment

The Government of Nepal has issued 'National Microfinance Policy, 2007' which aims to facilitate the creation of a conducive legal environment and the necessary financial infrastructure for further development of the microfinance industry in the country.

Developed professional management

A number of quality retail microfinance institutions with sufficient institutional capacity and professional management have developed in the last few years due to the

adoption of best practices and the development of their human resources to attain institutional and financial sustainability of their institutions.

Availability of domestic sources

A substantial amount of funds for microcredit programs are available from domestic sources (the commercial banks) under the mandatory Deprived Sector Credit Program.

Micro-insurance products

New products, such as micro-insurance products, have been introduced through a partnership between microfinance providers and a large insurance company. A number of self-managed micro-insurance schemes at an institutional level (without linking with an insurance company) have also been practiced in Nepal for more than a decade. New MFIs can replicate the scheme.

Opportunity for Commercial Banks

Microfinance as a new field provides a good opportunity for commercial banks. Very high rate of recovery and probability of higher profit gives a good opportunity to commercial banks for investment of their funds.

Operating in a professional manner

At present, a good number of MFIs are operating in a professional manner in the country, from which the upcoming microfinance leaders and practitioners can learn valuable best practices and good experiences of microfinance.

Women Empowerment

It is a positive outcome of microfinance that poor women now have access to financial services through Microfinance Institutions (MFIs), NGOS and other Nonbank Financial Institutions (NBFIs). Interesting and important point is that vast majority of them have excellent repayment records. By this way more effective utilization of resources becomes possible which ultimately plays a positive role in the economic development of the economy.

Conclusion

Microfinance services for the poor are now widely promoted as a key strategy for poverty reduction. Many microfinance programmes have increasingly targeted women in response to experience of excellent repayment rates. However, micro-finance is no magic. Badly designed micro-finance programmes (even if financially sustainable and female-targeted) may have very limited impact on poverty. Credit programmes may not enable people to

increase incomes but may accelerate a downward spiral of indebtedness. Female targeting may not benefit women but merely shift the burden of household debt and/or household thrift onto women.

Microfinance is comparatively a new branch of finance and in Nepal, it is almost at the stage of takeoff. Since 2000, this has observed rapid growth and performed tremendously as a market player. However, challenges are still there in the way ahead, which need to be faced with strategies policies. Besides, there are opportunities too which can be availed if government is keen to provide level playing field to the private sector market players in this area.

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