

## INNOVATION IN NEPAL MICROFINANCE AND BENEFITS FOR ASIA

(Paper prepared for presentation in a workshop "Sharing Microfinance Resources and Knowledge in South Asia to take place at Hotel Yak and Yeti on 27 February 2004)

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Nepal has become a unique laboratory of microfinance. Whether it is informal sector or in a formal sector, there are different modalities of providing financial services in the rural and the urban areas many of them with excellent performance.

### RURAL FINANCIAL SYSTEMS IN FORMAL SECTOR

#### **The first formal rural financial system**

The concept of cooperative emerged in 1961 when the cooperative movement was at its height in India and elsewhere. Villagers were asked to contribute grain in the **Grain Bin** so that it could be used in exigency. The political system existed after dislodging the first democratically elected government introduced cooperative systems named as SAJHA as their main economic programme. The capital for these cooperatives mainly consisted of the grains collected in the grain bins. These cooperatives were supposed to provide agricultural inputs (both in cash and in credit), market farm produce and to supply daily household provisions.

Land reform Saving Corporation was formed to supply necessary agricultural credit to the newly reformed landowners after the enforcement of Land Reform Program in 1964. Land Reform Saving Corporation was later merged into the Agricultural Development Bank in 1967. Agricultural Development Bank was established to provide credit requirement of the farmers for production of agriculture, livestock and fisheries etc. This bank was also aimed to providing credit for processing and marketing of produce those based mainly on agriculture and local resources.

#### **Commercial Banks in Rural and Microfinance**

Nepal Bank Limited and the Rastriya Baniya Bank (state owned commercial banks) were directed by the central bank to invest 5% of its deposits in agriculture cottage industries and services in 1974. The loans invested in these sectors named earlier as **supervision loan** was renamed to **small sector** and later it was redefined and called **Priority Sector** in 1976. Considering the huge demand of loan in the sector, the central bank instructed the banks to invest least 7 percent from of their deposit liability in this sector. In spite of this, the target could not be achieved because of the traditional tendency of the banks to emphasise collateral rather than the viability of a project. Thus, only individuals who were astute, influential and able to provide collateral benefited from this programme. Furthermore, investments were geographically scattered making supervision difficult. So, most of the loans were misused, loan repayments were minimal and the underprivileged sections of society denied credit lack of collateral.

## **Major Breakthrough in Microfinance**

As His Majesty's Government mandated the commercial banks and the Agricultural Development Bank to provide financial services to the rural poor people to stimulate income and employment generation, many programs were tested and some are still under testing.

### ***Small Farmers Development Programme (SFDP)***

Small Farmers Development Programme launched by the ADB/N as a pilot programme in two districts in 1975 and scaled up quite appropriately in the earlier days was a pioneer credit delivery programme which mobilised farmer groups with credit plus approach. The target population for this program was working poor (I guess it left the bottom quartile of the poor segment) leaving the hard core poor having more risk. Beneficiaries received credit and other socio-economic development components simultaneously through this programme. This programme neglected the values and importance of savings services. The graph of this widely appreciated programme declined rapidly as the programme was vigorously expanded (perhaps being the political pressure) in later years leaving behind the capacity of the organisation. This led to dilution of group approach, group cohesiveness and group dynamism resulting to the poor performance of the system. With the support of other institutions like GTZ, this programme is in transition toward community owned and managed Small Farmer's Cooperatives. ADB/N has initiated a strong financial and capacity enhancement backstopping to transform the programme into cooperative and run in a sustainable way. Formation of the Small Farmer's Development Bank is such an example.

The performance of SFCL is much better than transformation. The repayment rate has been dramatically increased, cost of operation significantly lowered and lending activities and products diversified.

### The lessons learnt

- A programme leads to failure if the growth and expansion is not managed properly.
- An MF programme reaches and maintains sustainability, only when it mobilises local financial resources.
- An MFI needs a strong banking support linked to mobilising resources in a sustainable way.
- An MFI can operate efficiently when its human resource is trained to a level needed to maintain records of transactions and accounts.

### ***Intensive Banking Programme under the Priority Sector Credit***

This programme was initiated in 1982 by Nepal Rastra Bank with many efforts to accelerating the priority sector lending. This is a well-coordinated programme that emphasises project viability instead of collateral, thereby allowing the underprivileged section of the society to take advantage of credit opportunities. This programme was an ideal carrier of development initiatives at the local level where banks' role was to coordinate developmental line agencies in a defined geographical area. Banks mobilising savings and credit for income generation in one hand and playing catalytic roles in

availing the services of concerned line agencies in the other hand facilitate development process in an intensified way was the major significance of this programme.

Two commercial banks were involved in this programme with intensive guidance, support and supervision of the central bank. The central bank raised minimum lending of seven percent of total lending up to 12 percent in this sector. The programme was expanded to almost all the districts. The commercial banks involved in this programme never perceived it as an ideal banking proposition but liability towards central bank. The central bank slowly loosened its support and grip. The minimum requirement in this sector revised requiring only to maintain three percent in the deprived sector. The commercial banks are trying to manage its more than half delinquent portfolios in the sector.

#### What lessons should we learn?

This is an exceptional development approach that concentrates all the development stakeholders in a particular area to provide services in an intensified way.

This programme gives better results if rights-based approach could be built in the programme.

The programme seems to be viable in the areas with dense population and developed infrastructure.

Formation of community organisations should be facilitated and linked with the banks in the consequent phases.

#### ***Grameen Bank replication/adaptation***

Replication of Grameen Bank model started with the initiation of the Nepal Rastra Bank in 1991 after the realisation that existing poverty lending models were not enough and appropriate to address the alarmingly increasing poverty. This was adopted upon its proven successful performance in Bangladesh. In this model, financial assistance is provided to the individual in a group by the bank on the strength of group's assurance and the transactions are held at the borrowers' proximity popularly called **Centre**. There are five government initiated regional rural development banks and some half a dozens of organisations including three private sector development banks. The Grameen model has been adapted retaining the essentials of the model. There has been significant difference in many aspects. This model has been able to provide quite a large segment of the poor in the country especially in the Terai region where the population is dense; road, market and other infrastructures are comparatively developed.

#### ***Banking With the Poor Programme***

Sir William K. Taylor, a philanthropist and a great visionary, founded "The Foundation for Development Cooperation" (FDC) in Brisbane, Australia in 1990.

In 1991, FDC launched the project **Banking With the Poor**. An Asia-Pacific regional workshop was held in Manila in which participants from commercial banks, micro-finance practitioners, bankers' associations and research & training institutions created a network.

The main objectives pursued were to explore, demonstrate and publicise the scope for increased access to credit on a sound commercial basis for the very poor in developing countries. In support of that goal, of access to credit for the poor, it has worked to

promote commercially sound linkages between the formal financial sector and well managed NGOs and SHGs of the very poor.

After the participation in the workshop, Rastriya Banijya Bank has been involved in the programme. The Bank demonstrated its commitment by expanding its operations in 32 branches spread over 18 districts of the country.

#### General Information on BWTP (Mid July 2004)

Programme started	1
Branch offices involved	27
Districts	18
NGO involved	1
Outstanding loans (in thousand NRs.)	
Number	6868
Principal	47967
Interest	34224

#### **How BWTP works in Rastriya Banijya Bank**

Under this programme, Self-Help Groups are formed and such groups are federated to form an association popularly known as ASHG. This association is linked with the bank branch. The process is principally carried out by an NGO. But in absence of such an NGO, an NGO named RUDA was formed by the involvement of the concerned staff of the bank to promote BWTP programme. RBB piloted this methodology of providing financial services in a commercial ground because of cost sharing mechanism is in-built in this programme.

#### The basic principle and practices underlying the programme:

Vision: In the future, ASHGs federation at the district level and assume the role of a district development bank and then act as conduit for channelling RBB and other banks' finance for poverty alleviation at the grassroots.

Targeting: Women those fall below the nationally defined poverty line.

Operating Principles: Savings first  
Market rate of interest i.e. SHGs free to set their own interest rate  
Group guarantee as collateral  
Small initial loan sizes

#### Long Term Goal

RB Bank's officials leading this programme had envisaged that the ASHGs operating within a district federated at the district level and assume the role of a district development bank under the Development Bank Act and function as a conduit for

channelling RBB and other banking finance for poverty lending at the grassroots. They also sought that RBB provides wholesale loans to this district level organisation.

#### Lessons to be learned from this programme

RBB enthusiastically implemented this programme as a pilot. But lack of appropriate piloting, which involves many steps of testing, standardising and replicating a programme in an appropriate pace. This also involves developing a business plan and human resource simultaneously.

BWTP was implemented in the bank without sufficient social preparation. There is still not a programme manual that clearly articulates vision, mission, goals and procedures. This resulted in inconsistency of the processes in different branches. No business planning process ever existed. No training and other activities carried out for human resource development. No lessons learned at any branch were documented and reflected in other programmes. So mistakes were frequently repeated. Proper monitoring and close supervision is still lacking since the pilot phase.

#### Review toward the objectives?

First, the programme has sought to explore, demonstrate and publicise the scope for increased access to credit on a sound commercial basis for the very poor.

Second, in support of that goal of access to credit for the poor, it has worked to promote commercially sound linkage between formal financial sector, non-governmental organisations and self-help groups.

No evidence shows that the programme is moving in line with the objectives laid down by the network.

#### The appreciable aspects

The most positive aspect of this programme is low cost involvement and cost sharing among the stakeholders. Peoples' acceptance and active participation is the other good aspect of this model. Programme impact study has not yet been carried out by any institution or individual but empirical evidence shows with cases that this programme has significant positive impacts on the lives of the poor people.

#### ***Savings and Credit Self-Help Groups and Cooperatives***

Thousands of savings and credit self-help groups emerged most of them spontaneously and with support of local and international non-governmental development organisations. Either it is a mother's group or a forest user's group, all most every woman in a village is involved in savings and credit group. Many such groups are converted into cooperative society with or without proper support of any organisation. There is a vast need to develop their capacity to manage their resources sustain ably. There is a great potential of linking these institutions/groups with the formal financial system. Some of the institutions such as Rural Microfinance Development Centre, Rural Self-Reliance Fund of NRB, Micro and Small Enterprise Division of RBB are among others to support such initiatives.

***Self-Help Group-Bank linkage programme*** can become the most suitable programme to avail micro financial services especially in the rural areas. This model can prove to

reaching financial sustainability earliest comparing to the other micro finance models. Similar types of programmes in India operated in similar situations have proved the viability of such programmes. Large financial institutions in India have ventured into microfinance by adopting such linkage model. The ICICI bank (second largest commercial bank in India) has a portfolio in excess of INRs. 60 crores (about US\$ 12 million) in direct lending to SHGs. Some 9500 SHGs have been promoted and linked with the bank for their credit and saving requirements.

### ***The future***

Various MF models have been developed and implemented in various parts of the world with various results and questions. There is ample of scope of devising most suitable MF models for particular geographic and socio-economic situations.

The paradigm has been shifted from providing financial services to the individuals of a group made in joint liability to group banking. The manta is now from ***individual banking to group banking.***

### The lessons based on new paradigm

The poor can be banked cost effectively

They can and do save (this is a human nature)

They can handle resources in a manner required by the formal system.

Collectively they can take financial and non-financial decisions for common good.

They are able to repay loans in time.

Peer pressure generated in the group is a good guarantee of loan.

They can graduate to micro entrepreneur.

There is a marriage of "Strengths" of formal system with the groups, which creates an atmosphere of trust leading to a "win-win" situation for both the stakeholders.

There is a shift from project banking to personal banking.