

**PROBLEMS AND POTENTIAL OF  
DEVELOPMENT OF MICRO FINANCE  
INSTITUTION IN NEPAL**

**A THESIS**

**Submitted By:**

**Dipty Gauchan**

**Campus Roll No. 2/2002**

**T. U. Regd. No.: 7-2-503-22-2002**

**People's Campus**

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# RECOMMENDATION

*This is to certify that the thesis*

*Submitted by*  
**Dipty Gauchan**

**Entitled:**

**Problems and Potential of Development of Micro Finance  
Institutions in Nepal**

has been prepared as approved by this Department in the prescribed format of the  
Faculty of Management. This thesis is forward for examination.

.....  
**Prof. Bijaya Prakash Shrestha**

**(Thesis Supervisors)**

.....  
**Prof. Bijaya Prakash Shrestha**

**(Head of Research Department)**

.....  
**Nirmal Mani Panthi**

**(Campus Chief)**

**VIVA-VOICE SHEET**

We have conducted the viva-voice examination of the thesis presented

By

**Dipty Gauchan**

Entitled:

**Problems and Potential of Development of Micro Finance  
Institutions in Nepal**

And found the thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirement for **Master Degree of Business studies (M.B.S.)**

Viva-voice committee

Head of Research Committee .....

Member (Thesis Supervisor) .....

Member (External Expert) .....

**Tribhuvan University**  
**Faculty of Management**  
**People's Campus**

**DECLARATION**

I hereby declare that the work in this thesis entitled “**Problems and Potential of Development of Micro Finance Institutions in Nepal**” submitted to office of the Dean, Faculty of management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the Master's Degree in Business Study (M.B.S.) under the supervision of **Prof. Bijaya Prakash Shrestha** **People's Campus, Paknajol, Kathmandu.**

Date:-March,2014

.....

**Dipty Gauchan**  
Researcher  
Roll No. 2  
T.U. Reg. No. 7-2-503-22-2002

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**Dipty Gauchan**  
**Researcher**

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## **ABBREVIATIONS**

ADB	Asian Development Bank
ADB/N	Asian Development Bank Nepal
BFIA	Bank & Financial Institute Act
BIDS	Bangladesh Institute of Development Studies
CEO	Chief Executive Officer
CFUG	Community Forest User Group
CLDP	Community Livestock Development project
CSD	Centre for Self help Development
DBs	Development Banks
DOI	Department of Irrigation
FIA	Financial Intermediary Act
FINGOs	Financial Intermediaries Non Government Organizations
FY	Fiscal Year
GDP	Gross Domestic Product
GON	Government Of Nepal
HPI	Human Poverty Index
IBP	Intensive Banking program
JFPR	Japan Fund for Poverty Reduction
LFP	Livelihood and Forest
MCPW	Micro Credit Project for Women
MF	Micro Finance
MFDEP	Micro Enterprise Development
MFDP	Micro Finance Development Bank
MFIs	Micro Finance Institutes
NESAC	Nepal South Asian Centre
NGOs	Non government Organizations
NRB	Nepal Rastra Bank
NTFP	Non Timber Forest Products]

PCRW	Production Credit for Rural Women
PFSF	Polli Karma Shahayak Foundation
PG	Policy Group
PGBB	Pachimanchal Grameen Bikash Bank
PRA	Participatory Rural Assessment
PWR	Participatory Wealth Ranking
R & D	Research & Development
RMDC	Rural Micro Finance Development Centre
RMP	Rural Micro Finance Program
ROA	Return on Assets
ROE	Return on Equity
RRDC	Regional Rural Development Bank
SCC	Saving & Credit Co-operating
SCG	Saving and Cooperating Group
SFC	Small Farmer Cooperatives
SFDP	Small Farmer Development Project
UK	United Kingdom
UN	United Nations
UNDP	United Nation Development Program
VDC	Village Development committee
WB	World Bank

# **CHAPTER 1**

## **INTRODUCTION**

### **1.1 Background of the Study**

The term 'Microfinance' has two components namely 'Micro' and 'finance'. The word micro is applied in terms of smallness by and large for representing the poor/low income people. The word 'Finance' which is suffixed with Micro represent small amount of finance matching the needs of the poor\low income people. Since needs of the poor goes beyond credit, the word 'finance' here is covering saving, insurance and other financial and non- financial services for their development.

Micro finance is the provision of financial services such as loans, savings, insurance, and training to people living in poverty. It is one of the great success stories in the developing world in the last 30 years and is widely recognized as a just and sustainable solution in alleviating global poverty.

The industry began by providing small loans to emerging entrepreneurs to start or expand businesses. Opportunity International was one of the first nonprofit organizations to recognize the benefits of providing capital to people struggling to work their way out of poverty. Over the years, with Opportunity leading the way, the microfinance sector has expanded its financial service offerings to better meet client needs. Along with providing more flexible loan products and business and personal development training, Opportunity offers savings and insurance to help clients effectively navigate the daily hardships they face. Without these services, clients are continually at risk of slipping back into poverty because of unforeseen circumstances.

Microfinance organizations make it a priority to serve the particular needs of women, since a staggering 70 percent of all those living in extreme poverty are female. Women are often excluded from education, the workplace, owning property and equal participation in politics. They produce one half of the world's

food, but own just one percent of its farmland. Nearly 85 percent of Opportunity's loan clients are women. While Opportunity gladly extends loans to men, the organization believes the greatest opportunity for interrupting cycles of extreme poverty come from microfinance programs that target female entrepreneurs. When women improve their circumstances, they also improve the lives of their children. By investing in nutrition and education, they help to create a better future for their children and their communities.

Despite the success of life-transforming microfinance services, the World Bank says that the industry is not close to meeting the demand. Five hundred million people living in poverty could benefit from a small business loan and only one-third of the world's population has access to any kind of bank account. The lack of access is particularly severe in sub-Saharan Africa where the World Bank estimates that microfinance is reaching only a small percentage of the economically active population. In sub-Saharan Africa's poorest countries, less than 10 percent of the population has an account with a financial institution. In response, Opportunity has committed to building scalable, sustainable and accessible banks throughout the developing world to provide loans, training, savings and insurance products tailored to the specific needs of each region.

As the microfinance industry continues to mature, there is a danger that it will drift toward a more secure client base. It is critical that microfinance organizations continue to focus on those with the greatest needs—those who have been displaced, those in rural areas, those who traditional institutions consider unbankable—the most marginalized people. Maintaining that focus, microfinance can help create a world in which the underserved have fair access to economic opportunities and the hope to move beyond poverty.

(Source: [www.opportunity.org](http://www.opportunity.org))

## **1.2 Micro Finance Market**

Micro finance services are provided by three types of sources in Nepal (ADB, 2000:25):

- ) Formal institutions such as rural banks and cooperatives
- ) Semiformal institutions such as non government organizations
- ) Informal sources such as money lenders and shopkeepers

### **1.3 Micro Finance Industries: It's Genesis**

Though the concept of microfinance is not new, it has been put into implementation for few decades only. World Bank has found to be invested in Microfinance projects from 1980, and then only it has got official and recognition. In Nepal it has been more than three decades that Micro Finance Industry is getting ground.

The Agriculture Development bank of Nepal initiated efforts to conceptualize and eventually implement Small farmers development program(SFDP) which started in 1975 as a hope for the million of small farmers scattered all over the country and it continued to operate with positive impact on the financial condition of these farmers. The SFDP is now being transformed into several autonomous self help organizations called Small Farmer Co-operative Limited which are managed by farmers themselves.

Another set of institution playing the role is commercial banks which introduced three micro credit programs: intensive Banking program (IBP), production credit for women (PCRW) and Micro credit project for Women (MCPW).

Intensive Banking program (IBP) was initiated in October 1981 to provide credit to lower income group and other rural household under the priority sector lending of commercial banks. Program was initiated in 1982 targeting the rural women.

PC production Credit for Rural Women (PCRW) program was followed by Micro Credit project for Women (MCPW) which was initiated in 1994 with an objective of developing NGOs as appropriate financial intermediaries that would provide quality micro credit services to the rural poor women over time

With a view to providing wholesale credit to NGOs and saving and credit

Co-operative through Nepal Rastra Bank, the government established rural self-Reliance Fund in February 1991.

In 1992 government set up two Grameen Bikash Banks as a replication of Grameen Bank Model of Bangladesh.

The establishment of Rural Micro finance Development Centre (RMDC) in October 1998 is yet another significant step in this direction.

**Table: 1**  
**Class: "D" (Micro Finance Development Banks in Nepal) Rs. in Million**

<b>S.No.</b>	<b>Names</b>	<b>Operation Date (A.D.)</b>	<b>Head Office</b>	<b>Paid up Capital*</b>
<b>1</b>	Purbanchal Grameen Bikas Bank Ltd.	1993/03/28	Biratnagar, Morang	60.00
<b>2</b>	Sudur Pashimanchall Grameen Bikas Bank Ltd.	1993/03/28	Dhangadhi, Kailali	60.00
<b>3</b>	Pashimanchall Grameen Bikas Bank Ltd.	1995/04/01	Butawal, Rupandehi	66.00
<b>4</b>	Madhya Pashimanchal Grameen Bikas Bank Ltd.	1995/04/01	Nepalgunj, Banke	73.57
<b>5</b>	Madhymanchall Grameen Bikas Bank Ltd	1996/07/08	Janakpur, Dhanusha	100.00
<b>6</b>	Nirdhan Utthan Bank Ltd.	1999/04/13	Siddharthanagar, Rupandehi	192.46
<b>7</b>	Rural Microfinance Development Centre Ltd.	1996/12/06	Putalisadak, Kathmandu	320.00
<b>8</b>	Deprosc Microfinance Development Bank Ltd.	2001/07/03	Ratnanagar, Chitwan	106.14
<b>9</b>	Chhimek Microfinance Development Banks Ltd.	2001/12/10	Hetauda, Makawanpur	126.02

<b>10</b>	Shawalamban Laghu Bitta Bikas Banks Ltd.	2002/02/22	Janakpur, Dhanusha	118.98
<b>11</b>	Sana Kisan Vikas Bank Ltd.	2002/03/11	Subidhanagar, Kathmandu	128.79
<b>12</b>	Nerude Laghu Bitta Bikas Bank Ltd.	2007/06/07	Biratnagar, Morang	40.00
<b>13</b>	Naya Nepal Laghu Bitta Bikas Bank Ltd.	2009/03/20	Dhulekhel, Kavrepalanchok	14.00
<b>14</b>	Summit Microfinance Development Bank Ltd	2009/05/20	Anarmani, Jhapa	17.50
<b>15</b>	Sworojagar Laghu Bitta Bika Bank Ltd	2009/09/12	Banepa, Kavre	10.99
<b>16</b>	Frist Microfinance Development Bank Ltd	2009/12/28	Gyaneshwor, Kathmandu	70.00
<b>17</b>	Nagbeli Microfinance Development Bank Ltd	2010/02/04	Anarmani, Jhapa	10.01
<b>18</b>	Kalika Microcredit Development Bank Ltd.	2010/07/21	Waling, Syanja	12.00
<b>19</b>	Mirmire Microfinance Development Bank Ltd.	2010/09/23	Banepa, Kavre	14.00
<b>20</b>	Janautthan SamudayikMicrofinance Dev. Bank Ltd.	2012-13/09	Butwal, Rupandehi	11.00
<b>21</b>	Mithila Laghu Bitta Bikas Banks Ltd	2009/04/29	Dhalkebar, Dhanusha	16.50
<b>22</b>	Womi Microfinance Bittiya Sanstha Ltd.	2012/03/08	Khanikhola, Dhading	10.20
<b>23</b>	Laxmi microfinance Bitiya Sastha Ltd.	2012/06/04	Nayabanesh War Kathmandu	70.20
<b>24</b>	ILFCO Microfinance Bisa	2012/12/25	Chuchepati	60.00

	Ltd.		Kathmandu	
<b>25</b>	Mahila Sahayatra Mf B.S. ltd	2012/12/25	Rajhar, Mawalparas	77.00
<b>26</b>	Vijaya Laghubitta B.S. Ltd.	2013/03/08	Rajhar, Mawalparas	77.00
<b>27</b>	Kisan Mf B.S Ltd.	2013/01/16	Kamalbazar, Achham	12.00
<b>28.</b>	Clean Village Mfs. Ltd.	2013/03/31	Hemja Kaski	14.00
<b>29.</b>	FORWARD Community MFB.S Ltd.	2013/05/17	Duhabi, Sunsari	70
<b>30</b>	Reliable MfB.S. Ltd	2013/05/19	Besisahar, Lamjung	14
<b>31</b>	Mahuli Samudyik Langhubitta BS Ltd.	2013/06/15	Bakdhuwa, Saptari	14
<b>32</b>	Suryodaya Laghubitta B.S. Ltd	2013/07/16	Putalibazar Syanja	14
<b>33</b>	Mero MfBs Ltd	2013/07/18	Battar, Nuwakot	69
<b>34</b>	Samta MfBS Ltd	2013/08/25	Pipra, Simara	11.06
<b>35</b>	RSDC Laghubitta B.S Ltd	2013/09/11	Butwal Rupandehi	60
Capital is based on Mid July 2013, Capital after establishment date is mentioned for new establish institution				

Source: NRB

## **1.4 Focus of the study**

The main focus of the study was to out the contribution made by the micro finance institution in employment generation and nation poverty reduction efforts. Although there have been several efforts made in poverty alleviation through different micro finance projects and micro credit programs from three decades, there is no positive result in poverty reduction so far. A more coordinated and concerted effort is required if microfinance is to spread and succeed. The study was also focused on what major steps should be taken by different MFIs to help the poor and deprived to sustain their lives. Nepal Rastra Bank has been constantly making efforts to make micro finance and micro credit easily accessible to rural people from its establishment. The study was concentrated on the financial sustainability and operation efficiency of micro finance institution and attempt to analyze the past trends and future prospects of MFIs in our country. It was also tried to find out the contribution made by micro credit on national poverty education efforts. And not the least it was also made an effort to find out the outreach of micro finance institutions throughout the country.

## **1.5 Statement of the Problems**

Nepal has a varied topography at varied development stages, a mix of different cultures and different ethnic groups, which challenges the successful delivery of micro finance. Although Micro finance programs have been implemented from three decades in Nepal, the majority of the poor is still left out of institutional services of microfinance.

Access to finance services such as loan, saving services, insurance and money transfer enable poor people to increase income and smooth consumption flows, thus expanding their assets base and increasing their ability to respond to crises. The study tried to find out the role of micro finance in poverty reduction. Micro specifically the study is an attempt to answer the following question:

1. Have microfinance services made significant contribution in the socio-economic status of the targeted community?
2. To what extent, microfinance service have generated employment opportunities and contributed to the national poverty reduction efforts?
3. To what extent these programs have promoted investments to rural areas and have empowered the people living there?
4. Have this program been able to mobilize local resources and develop saving habit among their participants?
5. Have these programs been able to mobilize local resources and develop saving habit among their participants?
6. Do the growth and development trend of micro finance industry in Nepal meet the expectation and requirement level of the nation and has given enough efforts toward proper utilization of its resources?

## **1.6 Objectives of the study**

The implementation of Micro finance program for several years in Nepal has demonstrated that given the opportunity, the poor is capable of making best use of scarce resources, generate good income and repay loan in time. Therefore the main objective of the study is to identify the proper mechanism that is better to the targeted group. The specific objectives are as follows:

1. To analyze the present circumstances of development of micro finance institution in Nepal.
2. To evaluate financial sustainability and operation efficiency of micro finance institutions in Nepal.
3. To identify the opportunities created by Micro Finance programs in poverty reduction and employment generation.
4. To examine the problem and potentials of micro finance.

5. To provide the recommendation for the study.

### **1.7 Significance of the Study**

Nepal has had a history of implementation of micro finance programs for more than three decades. During this period large number of microfinance institutions have emerged have with government & non government donor initiatives .Growth of MFIs has both positive and negative implication. It can help the expansion of outreach, the sustainability of these institutions and the growth of assets which in its own turn can help reduce operating cost. Even the most innovating and participative programs can lead to unwanted negative impacts. In many cases, microfinance has been shown to benefit the moderately poor more than the truly destitute.

Findings of this study are expected to help in targeting the right group of people to which the micro credit service is truly essential. It contributed the crucial part of any future effort which strengthens existing MFLs. Evaluation study need to be carried out to examine the effective of the MFIs; such an evaluation study helped assess the strength and weakness in the complementation of the programs and provided future guidance to the future.

### **1.8 Limitations of the study**

1. The study is based on secondary data published by respected institutional center. Therefore; reliability of study was upon accuracy and authenticity of the data published by the concerned sources.
2. Survey investigation has conducted by sampling method. As the sample are taken from those micro finance institutions which are related and acting as a partner for RMDC and registered in NRB. They may not always represent the population whole.
3. As the microfinance is related to people of lower income group, field visit to the rural areas and interaction with poor people is necessary to extract true information. Due to time constraint such visit is not possible.
4. Within Nepal there are wide ranges of institution active in microfinance sector. Most of them are not formally registered. So the samples are

taken from some formal institutions which are acting as partner institution of RMDC.

## **1.9 Organization of the study**

The preparation of the thesis has been organized into following five chapters:

**Chapter one** contains the introduction of the study which describes the major issues to be investigated, general background of the study, brief history of microfinance industry in Nepal, focus of the study, rational of the study, research hypothesis, plan of the work and limitation of the study.

**Chapter two** contains a discussion of the conceptual framework and review of major empirical works which consists of review from different books, journals, articles theses and past research works.

**Chapter three** describes the research methodology employed in this study which contains research design, population and sample and presentation and data analysis tools.

**Chapter four** is the presentation and analysis which contains presentation of data in various ways and its interpretation.

**Last chapter** is the summary, conclusions and recommendations. After the body of the thesis, bibliography and appendices is presented as supplementary materials.

## **CHAPTER 2**

### **REVIEW OF LITERATURE**

A literature review is a body of text that aims to review the critical point current knowledge including substantive findings as well as theoretical and methodological contribution to a particular topic. Literature reviews are secondary sources and as such, do not report any new or original experimental work.

Most often associated with science, finance –oriented literature, such as a thesis, the literature review usually precedes a research proposal, methodology and result section. Its ultimate goal is to bring the reader up to date with current literature on a topic and forms basis for another goal, such as the justification for future research in area.

A good literature review is characterized by:

1. A logical flow of ideas;
2. Current and relevant references with consistent, appropriate referencing style;
3. Proper use of terminology;
4. An unbiased and comprehensive view of the previous research on topic.

According to Copper(1988) a literature review uses as its data base reports of primary or original scholarship, and does not report new primary scholarship itself. The primary reports used in the literature may be verbal, but in the vast majority of cases report are written documents. The types of scholarship may be empirical, theoretical, critical/analytic or methodological in nature. Second a literature review seeks to describe evaluate, clarify and/ or integrate the content of primary report.

#### **2.1 Micro Finance Concept**

To most, microfinance means providing very poor families with very small loans (micro credit) to help them engage in productive activities of grow their tiny

businesses. Over time, microfinance has come to include a broader range of services (credit, saving, insurance, etc.) as we have come to realize that poor and the very poor that lack access to traditional formal financial institution require a variety of financial products.

Micro credit came to prominence in the 1980s, although early experiments date back 30years in Bangladesh, Brazil and a few other countries. The important difference of micro credit was that it avoided the pitfalls of an earlier generation of targeted development lending, by insisting on repayment, by charging interest rates that could cover the cost of credit delivery, and by focusing on client group whose alternative sources of credit was the informal sector. Emphasis shifted from rapid disbursement of subsidized loan to prop up targeted sector towards the building up of local, sustainable institutions to sever the poor. Micro credit has largely been a private (non-profit) sector institution that avoided becoming visibly political, and as a consequence, has outperformed virtually all other of development lending.

Traditionally, microfinance was focused of providing a very standardized credit product. The poor, just like anyone else, need a diverse range of financial instruments to be able to build assets, stabilize consumption and protect themselves against risks. Thus, we see a broadening of the concept of microfinance –our current challenge is to find efficient and reliable ways of providing a richer menu of microfinance products. The micro finance was first set up in the form of the Grameen bank in 1976 by Bangladeshi economist professor Muhammad yunus. Micro loan, he started which may be anything from a few pound upwards, are used for income-generating activities such as buying rice to husk and sell, or to protect a borrower from having to pay high rates to money lender for essential needs such as house repair, wedding or funerals. The loan is given at an interest rate higher than bank rate, to cover the high costs of administering small loans, but lower than money-lenders' rates. Saving is also crucial to microfinance, both institutionally in that they make up much of the loan capital, and also a safe place for people to deposit their money (Grameen Bank Micro credit summit, p.2-4 February 1997)

## **2.2 History and Development of the Micro Finance in the World**

The concept of microfinance is not new. Savings and credit groups that have operated for centuries include the "susus" of Ghana, "chit funds" in India, "tandas" in Mexico, "arisan" in Indonesia, "cheetu" in Sri Lanka, "tontines" in West Africa, and "pasanaku" in Bolivia, as well as numerous savings clubs and burial societies found all over the world.

Formal credit and savings institutions for the poor have also been around for decades, providing customers who were traditionally neglected by commercial banks a way to obtain financial services through cooperatives and development finance institutions. One of the earlier and longer-lived micro credit organizations providing small loans to rural poor with no collateral was the Irish Loan Fund system, initiated in the early 1700s by the author and nationalist Jonathan Swift. Swift's idea began slowly but by the 1840s had become a widespread institution of about 300 funds all over Ireland. Their principal purpose was making small loans with interest for short periods. At their peak they were making loans to 20% of all Irish households annually.

In the 1800s, various types of larger and more formal savings and credit institutions began to emerge in Europe, organized primarily among the rural and urban poor. These institutions were known as People's Banks, Credit Unions, and Savings and Credit Co-operatives.

The concept of the credit union was developed by Friedrich Wilhelm Raiffeisen and his supporters. Their altruistic action was motivated by concern to assist the rural population to break out of their dependence on moneylenders and to improve their welfare. From 1870, the unions expanded rapidly over a large sector of the Rhine Province and other regions of the German States. The cooperative movement quickly spread to other countries in Europe and North America, and eventually, supported by the cooperative movement in developed countries and donors, also to developing countries.

In Indonesia, the Indonesian People's Credit Banks (BPR) or The Bank Perkreditan Rakyat opened in 1895. The BPR became the largest microfinance system in Indonesia with close to 9,000 units.

In the early 1900s, various adaptations of these models began to appear in parts of rural Latin America. While the goal of such rural finance interventions was usually defined in terms of modernizing the agricultural sector, they usually had two specific objectives: increased commercialization of the rural sector, by mobilizing "idle" savings and increasing investment through credit, and reducing oppressive feudal relations that were enforced through indebtedness. In most cases, these new banks for the poor were not owned by the poor themselves, as they had been in Europe, but by government agencies or private banks. Over the years, these institutions became inefficient and at times, abusive.

Between the 1950s and 1970s, governments and donors focused on providing agricultural credit to small and marginal farmers, in hopes of raising productivity and incomes. These efforts to expand access to agricultural credit emphasized supply-led government interventions in the form of targeted credit through state-owned development finance institutions, or farmers' cooperatives in some cases, that received concessional loans and on-lent to customers at below-market interest rates. These subsidized schemes were rarely successful. Rural development banks suffered massive erosion of their capital base due to subsidized lending rates and poor repayment discipline and the funds did not always reach the poor, often ending up concentrated in the hands of better-off farmers.

Meanwhile, starting in the 1970s, experimental programs in Bangladesh, Brazil, and a few other countries extended tiny loans to groups of poor women to invest in micro-businesses. This type of microenterprise credit was based on solidarity group lending in which every member of a group guaranteed the repayment of all members. These "microenterprise lending" programs had an almost exclusive focus on credit for income generating activities (in some cases accompanied by forced savings schemes) targeting very poor (often women) borrowers.

**ACCION International**, an early pioneer was founded by a law student, Joseph Blatchford, to address poverty in Latin America's cities. Begun as a student-run

volunteer effort in the shantytowns of Caracas with \$90,000 raised from private companies, ACCION today is one of the premier microfinance organizations in the world, with a network of lending partners that spans Latin America, the United States and Africa.

**SEWA Bank:** In 1972 the Self Employed Women's Association (SEWA) was registered as a trade union in Gujarat (India), with the main objective of "strengthening its members' bargaining power to improve income, employment and access to social security." In 1973, to address their lack of access to financial services, the members of SEWA decided to found "a bank of their own". Four thousand women contributed share capital to establish the Mahila SEWA Co-operative Bank. Since then it has been providing banking services to poor, illiterate, self-employed women and has become a viable financial venture with today around 30,000 active clients.

**Grameen Bank:** In Bangladesh, Professor Muhammad Yunus addressed the banking problem faced by the poor through a programme of action-research. With his graduate students in Chittagong University in 1976, he designed an experimental credit programme to serve them. It spread rapidly to hundreds of villages. Through a special relationship with rural banks, he disbursed and recovered thousands of loans, but the bankers refused to take over the project at the end of the pilot phase. They feared it was too expensive and risky in spite of his success. Eventually, through the support of donors, the Grameen Bank was founded in 1983 and now serves more than 4 million borrowers. The initial success of Grameen Bank also stimulated the establishment of several other giant microfinance institutions like BRAC, ASA, Proshika, etc.

Through the 1980s, the policy of targeted, subsidized rural credit came under a slow but increasing attack as evidence mounted of the disappointing performance of directed credit programs, especially poor loan recovery, high administrative costs, agricultural development bank insolvency, and accrual of a disproportionate share of the benefits of subsidized credit to larger farmers. The basic tenets underlying the traditional directed credit approach were debunked

and supplanted by a new school of thought called the "financial systems approach", which viewed credit not as a productive input necessary for agricultural development but as just one type of financial service that should be freely priced to guarantee its permanent supply and eliminate rationing. The financial systems school held that the emphasis on interest rate ceilings and credit subsidies retarded the development of financial intermediaries, discouraged intermediation between savers and investors, and benefited larger scale producers more than small scale, low-income producers.

Meanwhile, microcredit programs throughout the world improved upon the original methodologies and defied conventional wisdom about financing the poor. First, they showed that poor people, especially women, had excellent repayment rates among the better programs, rates that were better than the formal financial sectors of most developing countries. Second, the poor were willing and able to pay interest rates that allowed microfinance institutions (MFIs) to cover their costs.

1990s These two features - high repayment and cost-recovery interest rates - permitted some MFIs to achieve long-term sustainability and reach large numbers of clients.

Another flagship of the microfinance movement is the village banking unit system of the Bank Rakyat Indonesia (BRI), the largest microfinance institution in developing countries. This state-owned bank serves about 22 million microsavers with autonomously managed microbanks. The microbanks of BRI are the product of a successful transformation by the state of a state-owned agricultural bank during the mid-1980s.

The 1990s saw growing enthusiasm for promoting microfinance as a strategy for poverty alleviation. The microfinance sector blossomed in many countries, leading to multiple financial services firms serving the needs of micro entrepreneurs and poor households. These gains, however, tended to concentrate in urban and densely populated rural areas.

It was not until the mid-1990s that the term "microcredit" began to be replaced

by a new term that included not only credit, but also savings and other financial services. "Microfinance" emerged as the term of choice to refer to a range of financial services to the poor, that included not only credit, but also savings and other services such as insurance and money transfers.

ACCION helped found BancoSol in 1992, the first commercial bank in the world dedicated solely to microfinance. Today, BancoSol offers its more than 70,000 clients an impressive range of financial services including savings accounts, credit cards and housing loans - products that just five years ago were only accessible to Bolivia's upper classes. BancoSol is no longer unique: more than 15 ACCION-affiliated organizations are now regulated financial institutions.

Today, practitioners and donors are increasingly focusing on expanded financial services to the poor in frontier markets and on the integration of microfinance in financial systems development. The recent introduction by some donors of the financial systems approach in microfinance - which emphasizes favorable policy environment and institution-building - has improved the overall effectiveness of microfinance interventions. But numerous challenges remain, especially in rural and agricultural finance and other frontier markets. Today, the microfinance industry and the greater development community share the view that permanent poverty reduction requires addressing the multiple dimensions of poverty. For the international community, this means reaching specific Millennium Development Goals (MDGs) in education, women's empowerment, and health, among others. For microfinance, this means viewing microfinance as an essential element in any country's financial system.

### **2.3 Brief History of Microfinance in Nepal**

The term microfinance was not used in earlier part of the history of rural microfinance. It has been found used in Nepal only in the later part of 1990s. Rural credit in Nepal began in 1956 with the opening of Credit Cooperatives in Chitwan Valley to provide loans to the re-settlers coming from different parts of

the country. The government through the creation of the Cooperative Development Fund (CDF) arranged some credit support to the resettlers through those cooperatives. In 1963, the government established the Cooperative Bank, which was later converted into the Agricultural Development Bank Nepal (ADBN) in 1968. The Cooperatives faced problems of shortage of fund for credit disbursement to their members on the one hand and misappropriation of borrowed fund for personal uses by some of their officials on the other. Hence, the government commissioned a fact-finding mission in 1968 to probe the operations of 1489 cooperatives then registered with the Department of Cooperatives and the mission found most of them at defunct stage and recommended for their liquidation.

Thereafter, the government introduced the Cooperative Revitalization Program in 1971. It authorized the Agricultural Development Bank Nepal to run cooperatives under its guidance and management. In 1976, 'Sajha Program' was launched and the Cooperatives were renamed as 'Sajha Societies'. The compulsory savings collected under the Land Reform Program of 1964 (2021 B.S) were converted into the share capital of the Sajha Societies. The NRB conducted a benchmark survey in 1983/84 to assess the situation of the cooperatives. The study found that 94% of cooperatives were dealing with transactions of agriculture inputs and 85% were also found extending credit. Most of the cooperatives were running at losses and over 75% of the outstanding loan was overdue for more than 1 year.

ADBN launched the Small Farmers Development Program in 1975 – first as pilot project at two sites, Sakhuwa Mahendranagar of Dhanush district in the Terai and Tupche of Nuwakot district in the hills. The strategy was to organize small farmers, tenants and landless laborers into groups and strengthen their receiving mechanism for tapping resources from service delivery agencies. Credit was provided under group guarantee. It also focused on developing a habit of thrift and personal savings among the members of the groups. They also started group savings to realize self-reliance in financial resources. A total of

142,711 members who were organized into 19,597 groups were benefited from the program by July 1991/92. After their installation of multiparty democracy in 1990, the government appointed a seven member National Cooperative Consultation Committee (NCCC) and dissolved the 'Sajha Central Committee'. It also provided constituted 11 members National Cooperative Development Board (NCDB) to provide policy directives to the cooperatives. The government enacted a new Cooperative Act in 1992 to ease promotion and development of cooperatives as a vehicle of economic development in the rural areas. The government also emphasized the role of cooperatives for extending credit facilities and other services to the rural people in its Eight National Plan.

The Nepal Rastra Bank (NRB) initiated Small Sector Lending in 1974 directing the commercial banks (CBs) to invest 5% of their deposit balance in Small Sector, which was later designated as the "Priority Sector Lending" in 1976. The NRB subsequently initiated "Intensive Banking Program" (IBP) in 1981 to boost up PSL lending to the low income group and required CBs to raise PSL to 8% of CBs' loans and advances, which was further raised to 12% in 1989. The main partners of PSL were the Nepal Bank Ltd. (NBL) and the Rastriya Banijya Bank (RBB) - the two state controlled CBs. The share of NBL and RBB in rural credit supply was 4.1% and 2.4% in the Sixth and 12.3% and 6.7% in the Seventh Plan periods. Loans under PSL were classified into agriculture, cottage industries and services. Target groups under PSL are low-income family with Rs. 2,511 or less per capita income per year. The beneficiary must contribute 20% of the project cost if the loan size was more than Rs. 15,000. NBL and RB charged 15% to 16% interest rates on priority sector loans. They provided loans up to 80% of the appraised value of the collateral for low income and 70% for the high-income families. However, these CBs provided loans to the group members of Production Credit for Rural Women (PCRW) formed by Women Development Section (WDS) of the Ministry of Local Development and the groups formed by the bank staff without collateral on just group guarantee. The loan limit for such loans was Rs. 30,000.

The Grameen Bank model of Bangladesh was replicated in Nepal with the establishment of Eastern and Far-Western Grameen Bikas Banks (GBBs) in 1992. The target groups included in Tarai the farmers with holding less than 1Bigha (0.67 ha) and in the hills with holding less than 10 ropani (0.5 ha), and the landless. It followed group approach in extending credit. Credit discipline was given top priority and loans were extended without collateral security on group guarantee. The board of directors of the GBBs comprised the NRB and CB representatives and headed by the Deputy Governor or Executive Director of NRB. The share capital of the first two GBBs was mainly contributed by the government and the NRB (75%), and by the CBs (25%). The first two GBBs started functioning from the middle of 1993. They charged 20% interest rate and the main source of fund for lending came from NRB and CBs. In the meantime, two NGOs – the Nirdhan and the Centre for Self-help Development (CSD) also launched microfinance programs replicating Grameen model in 1993 and 1994 respectively.

The financial Intermediaries Act was enacted in 1998 to regulate the financial intermediaries NGOs (FINGOs) on carrying out microfinance activities. This was claimed to be a breakthrough in legalizing the operation and activities of NGOs as microfinance operators. With the enforcement of this Act, two FINGOs, Nirdhan, and the Centre for Self-Help Development (CSD) also got registered under it. Later 47 NGO got license from the NRB to operate as FINGOs.

In 2004, the government introduced the Banks and Financial Institutions Ordinance (which was converted into an Act in 2006) which has a provision of licensing microfinance banks also as class 'D' banks. As a result, 13 microfinance banks have been issued license by the NRB till the date. In order to avail small wholesale funds to cooperatives and NGOs providing loans to the low income groups, the government had created a fund called Rural Self Reliance Fund (RSRF) in 1991 with Rs. 20 million was contributed from the government. The government with the assistance from ADB and NRB also

established the Rural Microfinance Development Centre Limited (RMDC) in 1998, to provide larger wholesale loans to MFIs through implementation of the ADB assisted Rural Microfinance Project (RMP). After the operation of RMDC, several MFIs were added in the microfinance market and the coverage by the microfinance institutions also increased with faster speed. The government had also instituted another wholesaler, the Sana Kisan Bikas Bank Limited (SKBBL) in 2001 to provide wholesale funds to the Small Farmers Cooperative Limited (SFCL) in 2001. With all these initiatives and efforts microfinance has gained a new momentum as an industry. Besides all these self-help groups also were promoted by several rural and community development projects of the government and donors to provide small credit to the self-help group members through grants for seed funds.

## **2.4 Microfinance Models**

There are quite a few prominent models of microfinance in the country. These include Cooperative model, SFCL model, Grameen Bank model, and Community based organizations (COs) or Self-Help Groups (SHGs) model. In addition, Production Credit for Rural Women (PCRW) and Village Banks are also considered separate programs/models of microfinance in Nepal. The programs like Decentralized Local Governance Support Program (DLGSP), Poverty Alleviation Fund (PAF) and some other rural development programs have also included microfinance as a component following the SHG model. Each model has its historical background and modus operandi of its own.

They are highlighted below:

### **a. Cooperative Model:**

#### **Historical background:**

The history of cooperative societies in Nepal dates back to 1956, when the government first started 13 cooperatives societies in Chitwan district. In 1963, the government established the Cooperative Bank, which later was merged into the Agricultural Development Bank, Nepal in 1968. Rural based cooperatives

were established mainly to distribute loans for agricultural inputs to farmers and trading of agricultural inputs and consumer goods to the local people both in cash and credit. These cooperatives were initially managed by the members and supervised by the Department of Cooperatives. Later, in 1973 the government decided to hand over the management of these cooperatives to the Agricultural Development Bank initially for a period of five years, which was subsequently extended by another five years. Later, the management of the cooperatives was again handed over to the members themselves in 1992.

In 1991, the government of Nepal enacted the Cooperative Act 1992. Under this Act, a group of 25 persons from a community can form a cooperative by registering it with the Department of Cooperatives, Ministry of Agriculture and Cooperatives. The Savings and Credit Cooperatives (SCCs) do not come under the regulatory framework of the Nepal Rastra Bank (NRB). However, some cooperatives that have been licensed from NRB for limited banking services have been providing services to non-members as well. They come under its regulation and supervision.

**Modus operandi:**

The SCCs can target all community members in a given locality irrespective of their social and economic status. Twenty-five people can get together to run a cooperative in their respective locality/village. Currently, most of the members of these organizations belong to well to do families who can make savings and the average membership is around 100 per cooperative. These cooperatives take savings deposits from their members and whoever wants to put savings in the cooperative is extended membership. They also provide loans to their members for a number of purposes. Loans provided to the members have a minimum term of three months to three years covering specific areas such as agriculture, housing, micro enterprises, or some social purposes. The SCCs are supposed to be self-regulated, which often are mismanaged due to the lack of control of members over the board of directors and members are not aware of the principles of a cooperative due to lack of membership education. These organizations have not been well regulated and supervised from higher authorities; as a result, many

of them do not have standard accounting and sound management practices. They also lack good governance. In spite of all these, SCCs are considered more suitable financing model for the hills and mountains as they provide both savings and financial services to the members who are the local people in a homely atmosphere without much of bureaucratic process. Due to low cost operation, their interest rates also are lower than other financial institutions. (Source: Microfinance Industry Report, 2008)

## **b. Small Farmer Cooperative Limited (SFCL) Model:**

### **Historical background**

The Agricultural Development Bank Nepal (ADBN) initiated the Small Farmer Development Program (SFDP) as a pilot project in 1975. The Food and Agriculture Organization (FAO) donated US dollar 30,000 to initiate pilot testing of SFDP at two sites, Sakhuwa Mahendranagar in Dhanusha district (Terai) and Tupche in Nuwakot district (Hills). At that time, FAO was providing technical assistance to seven nations of Southeast and South Asia to implement this program (FAO Program Document on SFDP, 1974 The program was first implemented in Vietnam, S. Korea, Laos, Thailand, Indonesia, Sri Lanka and India). After finding the successful implementation of the program in two pilot sites, the ADBN expanded the SFDP gradually to 422 sites covering a total of 652 VDCs in 75 districts, which catered around 188,000 small farmer families. The quality of service was somehow affected by the higher speed of expansion without developing the staff capabilities and failure to remain away from political pressure in implementation. (Source: Impact Evaluation of Microfinance Programs on Poverty Reduction, June 2008)

Later, an attempt was made with the technical and financial support of GTZ – German Technical Cooperation, Nepal to convert the Small Farmer Development Program Sub-Project Offices (SPOs) into Small farmer's Cooperatives. Institutional development for this conversion was initiated in 1988 under GTZ's Rural Finance Nepal Project (RUFIN). In 1993, four SPOs of Dhading district were first registered as Small Farmer Cooperative Limited

(SFCL). At present more than 228 SFCLs in 41 districts have been registered covering 139,368 members and 111,494 borrowers. Out of this, 11 SFCLs are entirely managed by women members and 219 SFCLs are affiliated to the Sana Kisan Bikash Bank Ltd. (SKBBL) Source: SFCL Model – Problems and Prospects – a paper presented in Microfinance Summit 2008 – a bank established in 2001 to

provide wholesale finance to SFCLs. SFCL model has been honored with CGAP/IFAD Pro-Poor Innovation Challenge Award-2003, as the best model of poverty alleviation. (Source: SKBBL Annual Report, 2008.)

#### Modus operandi

SFCL has a three tiers structure. At the village level, promoters facilitate local household members to form groups; at the ward level. The farmers' groups with common interest and proximity are integrated into inter-group associations and at the VDC level, all groups and inter-groups are represented in the Executive Committee. For the operation of the SFCL, the Executive Committee is formed of the members elected by the General Assembly. The Executive Committee is responsible for hiring the Manager and other staffs and for deciding on the rules and regulation needed to ensure the smooth and effective operation of the organization.

The grassroots' groups organize regular meetings to collect mandatory savings and loan repayments and applications for loan demand. These loans applications are forwarded to their respective inter-groups, which appraise them and forward with recommendations to the Executive Committee for final decision. The SFCL is generally confined to one VDC area and it targets only at the small farmers. The loans are extended mainly with collateral security.

They also make some loans without collateral security. However, such cases are less than 10%. Each SFCL in an average serves around 500 households.

SKBBL provides them with wholesale loans while the Federation of SFCLs regularizes and supervises their financial activities. SKBBL has provided

wholesale loans to 219 SFCLs. Some 60 SFCLs are demonstrating very good performance. Some of them have generated sufficient internal resources and are having an annual transaction of Rs. 40 – 60 million. However, these SFCLs have been borrowing a few hundred thousand rupees from SKBBL just to maintain good relation with it. Some SFCLs have also borrowed from RMDC. It is reported that some SFCLs have also been providing larger size loans to the graduated clients so that they do not lose these clients to other banks and financial institutions. Some also provide enterprise loans larger than the NRB defined ceiling of Rs. 150,000. (Source: Mr. Jhalendra Bhattarai – Manager, SKBBL.)

### **c. Grameen Bank Model:**

#### **Historical Background:**

The Grameen Bank concept of lending propounded by Prof. Muhammad Yunus of Bangladesh was introduced in Nepal during 1990s by the GoN and NRB by establishing five regional Grameen Bikas Banks (GBBs), one each in 5 development regions of Nepal. During the same time, two national level NGOs namely the Nirdhan and the Centre for Self-help Development (CSD) also launched microfinance programs replicating the same Grameen model and later they also established two microfinance development banks, Nirdhan Utthan Bank Limited (NUBL) at Bhairawa and Swablalmban Laghubitta Bank Limited, (SB bank) at Janakpur adopting the Grameen model. Similarly, other prominent NGOs - Chhimek, DEPROSC, NRDSC, FORWARD, and Jeevan Bikas Samaj (JBS) - also started their microfinance programs following this model. At present, GBBs, Private Microfinance Banks (PMFBs) and a host of FI-NGOs and SCCs are also providing microfinance services to the poor following Grameen model.

#### **Modus Operandi:**

This model is comparatively more successful in areas, where the market and road infrastructure is more developed and economic activities are vibrant. It is more feasible in Terai than in the hills and mountains. The approach is based on

the formation of peer groups each comprising five members. Three to ten such peer groups form a center at a particular location – close to a village, where they meet once every week or fortnight or month as decided by the members. Each group elects a group chairperson and each center a center chief to oversee the activities of group members and maintain group discipline, check utilization of loans and ensure timely repayment of loan installment. In such meet, group members collect savings and make demand for loans and also settle the loans or interest due and repay loan installments as per schedule. They do not need to provide collateral security for the loans but need to provide group guarantee for repayment. To begin with, the potential target groups are identified with Participatory Rural Appraisal (PRA) techniques or Participatory Wealth Ranking (PRW) exercise to identify the target groups. After the target groups are identified, the eligible members participate in a weeklong pre-group training (PGT) or a compulsory group training (CGT) on microfinance procedures and organization and operation of groups and centers. The MFI field staff facilitates the fortnightly or monthly meeting, where they also collect mandatory and voluntary savings, loan repayment installments and loan demands from the members and also verifies the utilization of disbursed loans. The GBBs still follow the weekly meeting and other procedures of the traditional Grameen Bank model, while the replicating Private MF Banks and FI-NGOs have adjusted the model to suit their local conditions and requirements. Some of the institutions following Grameen Bank model also have diversified saving schemes such as education savings, pension fund savings, micro-insurance covering risks related to loans, life, health and their livestock as in Grameen Generalized System (GGS).

Some dynamic groups also deal with other social problems and issues related to community and take necessary actions to resolve.

#### **d. Self-Help Groups (SHGs)/Community Organizations (COs) model:**

##### **Historical background:**

In Nepal there are several forms of informal self-help groups such as ‘dhukuti’,

mothers' group, and many other groups with specific objectives.

This type of SHG needs not be pro-poor focused. Mostly, lower middle or middle class people are involved in this type of SHGs.

Another most popular informal self-help group is Aama Samuha (mothers' group). Mothers' group is mainly formed and activated by the local women with one or more objectives that could be related to income generation aspect and/or removing social evils and bring about positive changes in the society. Women empowerment is the main objective of the most mothers' groups.

These mothers' groups organize campaigns against alcoholism, injustice to women, girl trafficking, and other social evils. They also mobilize their savings and provide credit to the needy members. However, these are not necessarily targeted at the poor. They are very common in the hills and mountains. They have been in practice now for more than 3 decades. They used to be widely practiced in the hills and mountains of Western Development Region. However, these groups are not recorded anywhere.

In India, SHG model is widely applied in a number of states by the banks with a view to extending microfinance services to a large number of poor communities at a lower cost of transaction. They are also linked with the commercial banks for loans. However, in Nepal SHGs are not tied up with the formal banking institutions as yet except those promoted by WDS. SHGs or COs are formed and promoted under a number of rural development programs implemented by different agencies, such as Production Credit for Rural Women (PCRW – started in 1982), Participatory District Development Program (PDDP) and Decentralized Local Governance Support Program (DLGSP) supported by UNDP, and Poverty Alleviation Fund (PAF) funded by the World Bank.

Rural development programs also organize Community Organizations (COs) or Self-help Groups (SHGs) as vehicles for expediting people's participation in the programs. Such programs focus on poverty reduction through local capacity building as in DLGSP and PAF. In most cases, SHGs/COs undertakes savings

and credit activities as well for enterprises development and livelihood improvement. In DLGSP, the COs receives some counterpart funds as seed money to the groups or the COs for providing financial support to their members for implementing economic activities or entrepreneurial development programs. The projects also provide various capability enhancement trainings to the COs. Some development agencies have converted these into savings and credit cooperatives by registering them with the Department of Cooperatives. However, most of them have remained informal and have gradually become non-functional after the projects are phased out. They also have failed to develop linkage with the formal financial institutions due to lack of legal status.

### **Modus Operandi:**

The 'Dhukut' system is a very old form of self-help group in Nepal; it has been in operation for more than 4 decades. Closely affiliated and well-acquainted persons form a group and start contributing a specified amount at specified intervals of time. In each collection meeting, the cash collected is given to one of the needy members for use as per the rules set unanimously by the group.

Rules are found generally unwritten, but agreed by all in the inception meeting. The member who has used the amount will also continue contributing the time bound amount till all the members get chance to use the money raised in each sitting. The essence of this practice is that with small installments contributed by all group members one needy member can use a huge sum of money that can accomplish a larger activity generating a lasting source of income. It is a self-help approach to development of members.

Those who use the fund at the earlier opportunity can turn over the money and get benefited more through the time value of money. In this system, members do not need to pay interest as such, but depending on the rules they make, early seekers of the sum have to get little less money than what is collected in total and the last holder of the chance may just collect his/her total deposit and/or little more money left by the early seekers. Members may also make a rule to enjoy the surplus money by organizing picnic or opening lottery, which provides the lucky ones with surprise prizes.

The Local Development Fund (LDF) under PDDP and DGLSP assists local communities to get local people organized into Community Organizations (COs)/SHGs in various settlements within the Village Development Committee (VDC). COs are organized for separate groups for men or women or both. The COs also mobilizes compulsory and other types of savings.

Generally they charge 10-12% interest per annum to the borrowers under their lending schemes. COs conduct regular meetings in which members apply for loans and also collect due installments. COs determine the interest rates and other terms and conditions of loans if they lend money using their own savings. If a member demands more money than the CO can provide from its savings, the member would have to fill a separate application form addressed to the Local Development Fund (LDF). The CO recommends the loan and forward to the LDF for approval. Similarly, PAF also organizes local groups of the target families known as COs through the use of local NGOs. They are provided with seed fund at the rate of Rs. 3,000 per family member. They are informal groups and not linked up with any financial institutions. They also charge about 10% interest per annum.

#### **e. Village Bank Model:**

##### **Historical background:**

The Village Bank (VB) model was evolved from Latin America and tried out in Nepal between 1998 and 2001 in USAID funded Women Empowerment Project (WEP) through PACT-Nepal. Village Banks are grassroots level financial institutions – community-managed savings and credit associations aimed at providing financial services to community women through the mobilization of their own resources and achieve financial self-reliance. They have been promoted by the Pact Nepal in collaboration with some local NGOs and Cooperatives in the Terai region of Nepal. The project also lent some money to build up the external account of the VB, which was then lent to its members. However, they have not been linked up with the financial institutions and most such banks have been non-functional after the phase out of the project.

**Modus Operandi:**

A typical VB consists of 40-50 women. It begins with a literacy class of six months where savings credit operation process also was taught. Later, the VB mobilizes member's savings for providing loans for both productive and consumption purposes to the needy women members and also provided support for the capacity building of the banks. A member generally gets Rs. 3,000 to 10,000 at a time. The loan size depends on the amount of the savings available in the Village Bank. At the end of 16th week, the loan cycle must also end. All loans must be paid back to get new loans released. This is also called zero gathering, as old loans are settled and new loans are given in this gathering making a zero balance. Interest is not given on the savings deposits; however, at the end of each loan cycle, benefits from the proceeds are shared in proportion to the savings deposits. Benefits are distributed in the form of savings to the corresponding savings accounts based on a minimum balance kept for at least nine weeks instead of providing cash to the member depositors. The village banks generally charge 24% interest per annum and interest is collected upfront basis. The management of the VB is generally done by the chair, the secretary and the treasurer elected by the members.

They keep all the records, minutes and books of accounts maintained by themselves and all the documents are put in a tin box, tripled locked by all the three officials and opened and locked in the meeting in front of all the members. Things are all kept transparent to the members. Such VBs have not been linked up with any financial institution during the project. However, some VBs have been linked with one SCC in Nawalparasi district under RMDC loan support. This model has advantage and suitability in the less accessible and the remote parts of the districts in Nepal.

**2.5 Concept of Poverty**

Poverty is the state of one who lacks a certain amount of material possessions or money. Absolute poverty or destitution refers to the one who lacks basic human

needs, which commonly includes clean and fresh water, nutrition, health care, education, clothing and shelter. About 1.7 billion people are estimated to live in absolute poverty today. Relative poverty refers to lacking a usual or socially acceptable level of resources or income as compared with others within a society or country. For most of history poverty had been mostly accepted as inevitable as traditional modes of production were insufficient to give an entire population a comfortable standard of living. After the industrial revolution, mass production in factories made wealth increasingly more inexpensive and accessible. Of more importance is the modernization of agriculture, such as fertilizers, in order to provide enough yields to feed the population. People who practice asceticism intentionally live in poverty.

The supply of basic needs can be restricted by constraints on government services such as corruption, debt and loan conditionality's and by the brain drain of health care and educational professionals. Strategies of increasing income to make basic needs more affordable typically include welfare, economic freedom, and providing financial services. Today, poverty reduction is a major goal and issue for many international organizations such as the United Nations and the World Bank. Source: [Poverty (sociology). britannica.com. Retrieved 2010-10-24.]

**United Nations:** Fundamentally, poverty is a denial of choices and opportunities, a violation of human dignity. It means lack of basic capacity to participate effectively in society. It means not having enough to feed and clothe a family, not having a school or clinic to go to, not having the land on which to grow one's food or a job to earn one's living, not having access to credit. It means insecurity, powerlessness and exclusion of individuals, households and communities. It means susceptibility to violence, and it often implies living in marginal or fragile environments, without access to clean water or sanitation. (United Nations. Retrieved 2011-05-27. )

**World Bank:** Poverty is pronounced deprivation in well-being, and comprises many dimensions. It includes low incomes and the inability to acquire the basic goods and services necessary for survival with dignity. Poverty also encompasses low levels of health and education, poor access to clean water and sanitation, inadequate physical security, lack of voice, and insufficient capacity and opportunity to better one's life. (Source: Worldbank.org. Retrieved 2011-05-27.)

## **2.6 Importance of Micro Finance Institution**

Micro finance is regarded as effective tools for poverty alleviation. The Asian Development Bank (Finance for the poor: Micro Finance Development strategy, 2000) has recognized micro finance as a powerful tool to promote economic growth, reduce poverty, support human development and improve the status of women. For the past 2 year, the government, international agencies and social organizations have been focusing on women's development programs. The main priority of the tenth periodic plan was poverty alleviation, women's empowerment and gender mainstreaming. Most of the poor people live in rural areas and have little opportunity.

Micro-finance could help poor people who have no collateral, but a willingness to work and a desire to do some business activities from which he/she will acquire employment as well as income. Most of the poor people live in rural areas and have little opportunity. Therefore, Microfinance could help poor people who have no collateral, but a willingness to work and a desire to do some business activities from which he/she will acquire employment as well as income. What is more, the economically isolated, which means that their market is often local, small and does not offer any demand growth prospects.

Commercial banks and other financial institutions normally do not like to go in that area because of the geographical constraints, underdeveloped infrastructure and other physical constraints. However on the other is a substantial demand of micro credit in the rural areas. In this scenario, locally operating micro finance

institutions such as SFCL could obviously borrowed fund / grant to the local rural people (Dhakal, 2002). Micro finance is equally important to both men and women because of gender-based forms of exclusion. Women become poor through deterioration in the household's access to resources. Women's lives are governed by more complex social constraints and responsibilities than men's and they are more concentrated in the non-monetized sector.

In almost every Asian country, women comprise a large percentage of the poor. The existence of the gender complexities in the handling of income affects the quality of family life, the quality of children's nutrition and education, as well as household stability. Unless and until women do not have access to economic opportunities, poverty cannot be reduced.

## **2.7 Limitation of Microfinance in Nepal**

There are many problems and limitations relating to the microfinance institution in Nepal. The major constraints, the micro finance system facing today are:

1. Weak institution capacities of Micro finance institution and weak performance level and financial conditions of Grameen Bikash Bank. Lack of effective management information system and operating system in managing accounts, tracking loans, analyzing institution performance on time.
2. Higher lending rate to MFIs by RMDC is also one of the major constraints to the loan disbursement program.
3. Vulnerable security situation in hilly and terai area due to Maoist insurgency in past years make Micro Finance institutions hesitant to expand and expand outreach to rural and remote areas.
4. Limited credit absorption capacity of clinics is another major limitation in the growth of sector which makes MFIs hard to find as equate number of good clients which shows the unsatisfactory performance level of micro enterprises loan program.

5. The poor and women, who are actually in need of these services, are not inclusive in the target group of co-operatives. Most of the co –operatives have been limited to one or few village development committee.
6. Composition of higher income tax rate on MFIs' hard income has also discouraged them to work hard in the field of social development and poverty alleviation program.
7. Inadequate equity of MFIs has limited their lending operation to a greater extent. Most of these institutions do not have access to grants, funds or subsidies for their operational costs or lending which would have helped to increase their equity to certain extent.

The major challenges ahead in successful micro credit delivery in Nepal can be listed as follows:

- a. Formulation a micro credit delivery mechanism that is better suited to people living in hilly and mountainous areas.
- b. Successfully extending the outreach of microfinance service to the hills and mountains.
- c. Redesigning existing program of the formal MFIs to better target the poorest.
- d. To make sustainable the delivery mechanism of government initiated Micro Finance Institution and programs.

## **2.8 SWOT Analysis of Micro Finance Institution in Nepal**

The absence of commercial bank in most of the rural parts of the country and the inability of the small farmers to get credit in times of need provided room to these non conventional forms of lending MFIs are one of these major type of institution that have not only achieved a degree of success but they have also managed to attract donor support. There are several reasons for this. Micro Finance has been to give poor people access to financial service. Micro Finance System in generally characterized by relatively small loans and easily available at their doorstep. The risk involve in lending money without collateral is overcome by giving the customer good involved to repay their loans. The

repayment period is relatively short. The repayment rate is quite high, which is attributed to the informal participatory structure which makes debtors aware of their obligation. Regular meeting reinforce a culture of discipline, routine repayments and staff accountability.

Fragmentary studies show that participants of such programs usually have higher and more stable income than they did before they joined the program. The implementation of microfinance programs for several year in Nepal has demonstrated that given the opportunity, the poor is capable best use of scarce resources, generate good income and repay the loan in time.

Micro-Finance programmers not only give women and men access to saving and credit, but reach millions of people worldwide bringing them together regularly in organized groups. Although no 'Magic bullet', they are potentially a very significant contribution to gender equality and women's empowerment, as well as pro-poor development and civil society strengthening. Through their contribution to women's ability to earn an income these programmers have potential to initiate a series of 'virtuous spirals' of economic empowerment, increased well-being for women and their families and wider social and potential empowerment. Micro finance services and groups involving men also have potential to question and significantly change men's attitudes and behaviors as essential components of achieving gender equality.

Such micro finance programs are also providing necessary training to their clients for strengthening their group and improving their entrepreneurial and income grating skills. The training programs may include adult literacy and non formal education, gender sensitization, group development, leadership development, entrepreneurial and occupational skills development.

Micro Finance Service are helpful to the poor enable them to finance specific private income generating activities to increasing their income. However it is essentially important to make sure that the loan facilities provided are not utilized for consumption purposes. If the action of such borrowers is imitated by

other poor people, the it could produce negative impact on the future growth of microfinance.

The majority of the poor, who is actually in need of Micro Finance services, are still left out. Although the microfinance service is in service for three decades such programs have only limited impact in term of increasing the outreach of microfinance to the poor. The real challenges facing the microfinance industry today is scaling up services to reach the ultra poor people, living in hills, mountains and interior areas of the terai region. It is estimated that more than eighty percent of the total poor families still depend upon informal sources to meet their credit need or have no access to any source of credit at all. Majority of prospective clients especially Nepal's rural women population below poverty line are still left out from the institutional service of micro finance programs or have failed to benefit from them to the desired extent.

## **2.9 Regulatory Framework of Micro Finance Institution in Nepal**

In Nepal, microfinance activities are regulated under the newly promulgated "Bank and financial ordinance 2004", which covers category D 'Microfinance Development Bank', not allowed to perform regular development bank activities and category E. "NGOs as financial intermediaries". The ordinance includes the two specific acts promulgated by the parliament in recent years (ADB, 2000:17).

- J Nepal Rastra Bank Act, 2002
- J Commercial Bank Act, 1974
- J Agricultural Development Act, 1967
- J Development Bank Act, 1996
- J Financial Intermediary NGOs Act, 1998
- J Co-operative Act, 1992

The first attempt to provide any regulatory basis for financial promotion activity in the country was made when devised the concept of the limited banking license for NGOs and cooperatives. This license provides for supervision by NRB of the

registered MFIs in exchange for permission to undertake limited deposit taking from members. This measure was followed in 1996 by the Development Bank Act, which provides for the establishment of financial institutions that have the mandate to operate in a more relaxed financial framework than the commercial banks. Regional Rural Development Banks are registered under this Act, which provides regulation by NRB. In 1999, Nirdhan, the largest MFI in Nepal, also obtained a development banking license for its entire microfinance portfolio to the new bank.

However, the most recent initiative to provide a regulatory framework to micro finance in Nepal turns into something of a fiasco. The FISA requires that NGOs registered under the Registration of Associations Act, 1977 with objective of working as a financial intermediary are to be registered with NRB and too regulated by it (Sinha, 1999:12). On February 24, 2003, NRB issued regulation for the development banks, which are engaged in micro finance, as a guideline to develop MFIs activities.

There are various micro finance institutions established in Nepal to date. There are micro finance wholesale Apex Institutions also, which are acting as the intermediary to provide financial services to the rural poor households, specially woman of the village, through micro finance institutions. Such as, Rural Self Reliance Fund (RSRF), Rural Micro Finance Development Center Ltd. (RMDC), Commercial Bank (CB).

The central bank, Nepal Rastra Bank imposes 'priority sector' lending to commercial banks, which entails lending a certain percentage of their deposit liability to deprived population, including the usual microfinance clients. The ratio of priority sector lending over time has increased from 5% to 12% in which 0.25 to 3% must be invested in the 'deprived' sector, which aims at targeting the hard core poor. Commercial banks can choose to lend the required amount to end clients directly, or disburse it through loan or equity in other microfinance institutions. Because of the creation of new wholesale funds and the liberalization of the financial system, NRB has recently decided to phase out its

priority credit policy by 2007, with decreased ration of 6% in 2004, and 2% in 2006. However, the 3% deprived sector requirement will stay in place, and include micro finance. As of mid July 2003, RS22,605 million was injected in the priority sector, while Rs 3,563 million was allocated to deprived sector lending, from which 132.6 million was in the form of equity (BWTP; 3)

Under this priority sector lending agenda, the central bank has been playing an unusual development role, justified by the lack of commercial bank interest to lend in rural areas and the weak formal microfinance sector. NRB has directed microfinance oriented programs such as the Intensive Banking Program, which introduced group guarantee mechanisms in place of formal collateral, the Production Credit for Rural Women (PCRW) and Micro-credit for Women (MCPW), which targeted low- income women, and were supported by donor agencies such as IFAD or the ADB. In 1992, NRB introduced the Grameen Bank model in Nepal by establishing five Regional Rural Development Bank, each operating in a separated development region. NRB also manages the Rural Self-Reliance Fund (RSRF), established in 1191, which provides wholesale lending to NGOs, cooperatives and financial intermediaries.

## **2.10 Scope, Impact and Role of Micro Finance Institution in Nepal**

The area impact and the role of the microfinance institutions can be depicted as below:

### **Individual Level**

- ) Awareness
- ) Self-dependent
- ) Access and control over productive resources
- ) Enhancement of confident level in decision making

### **Household Level**

- ) Changing attitude of family members
- ) Sharing of financial activities among spouses

- ) Economic contribution
- ) Self-respect in the family

### **Organizational Level**

- ) Management of organization activities
- ) Sharing of responsibility
- ) Resource mobilization
- ) Opportunity for skill enhancement, education and generating activities

### **Community Level**

- ) Involvement of women in public sphere
- ) Increased cooperation between male and female
- ) Interaction in a group
- ) Women solidarity

## **2.11 Developing/Changing Trend in Micro Finance Sector**

Microfinance has been around for about three decades and it has evolved significantly as new loan products and new lending/business models were invented and new markets were explored. Many microfinance providers, who started off as not-for profit setups, later grew to become large non-banking financial institutions that offered an array of financial services apart from loan. A few of these grew to scales that warranted IPO's as well (Micro Banking Bullentin, Issue 18, 2009).

This is not surprising. The bottom of the pyramid because of its sheer volume, presents great opportunity for business minded entities that wish to provide loan or insurance products. However, credit risk and opportunity go hand, and as old challenges in microfinance are addressed, new ones keep emerging. This post talks about a few positive and negative trend in the microfinance sector, based on which, we can confidently say that this sector will soon grow into a complex and thriving industry.

In the face of several obstacles, there are certain encouraging trends taking place as business and governments realize the importance of the development sector. Below are a few noticeable initiatives being adopted by Micro finance institutions as they look for ways to further penetrate markets and make their credit ventures sustainable. They are:

- ) Microfinance trend 1- diversification of Microfinance Institution: microfinance providers are beginning to broaden the range of services offered under the microfinance umbrella which started with loans, but now includes insurance, saving and money transfer facilities as well.
- ) Microfinance trend 2- Specialization of Microfinance Institution: microfinance providers are beginning to focus on certain livelihoods such as crop insurance, loans for handicraft businesses, or loans for fisheries, etc. As microfinance institutions study each business model, they can design products that are aligned with the unique cash flow cycles or the varying demand patterns of the client's business.
- ) Microfinance trend 3- turnkey Solution: microfinance institutions are beginning to provide services other than loans and savings, to support their clients' business. Such services include assisting clients with supply chain management, or sharing 'marketing infrastructure to enhance these micro-businesses.'
- ) Microfinance Trend 4- New channels: clients no longer have to visit physical offices of microfinance institutions in order to repay loans or acquire a new credit line. Franchise-based business models and branchless banking are becoming effective ways of reaching potential clients who often live in disparate rural areas. An example of this is Kiva's API platform called Buld Kiva.

## **2.12 Review of Related Studies in Nepal**

### **2.12.1 Related Articles**

A case on his study published in 'The Kathmandu Post' date 28<sup>th</sup> January, 2010 of "Microcapital brief: Liquidity Crunch Forces Nepalese Microfinance

Institutions (MFIs) to Increase Lending Rate” by Stefanie Rubin, Research Assistant: Nepalese microfinance institutions (MFIs) that used to borrow from commercial banks at a four percent interest rate now have to borrow at seven percent—a 75 percent increase—due to the liquidity crunch. As a result, MFIs are passing these costs on to their borrowers.

“Higher lending rates of banks and financial institutions have compelled us to increase our lending rate.... We have to make an immediate move to increase the lending rates,” said Mr Harihar Dev Pant, Chairman of Nirdhan Utthan Bank, a Nepalese MFI with over 68,000 active borrowers.

MFIs in Nepal lend roughly NPR 30 billion (USD 415 million) annually, but could face a shortage of up to NPR 15 billion (USD 207 million) due to the liquidity crunch, reported Mr Tejhari Ghimire, CEO of the Centre for Micro-Finance (CMF), a Nepalese microfinance consultancy firm.

The Centre for Micro-Finance was established in Nepal in 2000 with the purpose of providing training, technical assistance and consultancy services for microfinance-related activities.

CMF began as a project implemented by the Canadian Centre for International Studies and Cooperation (CECI) with funding from the United States Agency for International Development (USAID). According to its website, “CMF is now an autonomous, sustainable and wholly privately owned Nepali Company which is capable of providing technical services to strengthen the MF sector in Nepal and the region.”

A case on his study published in ‘Himalayan Times’ date February, 2011 of “Micro-finance in Nepal” by Nav Raj Simkhada: The Micro-finance Summit Campaign has prescribed four core themes for the industry: reaching the poorest; reaching and empowering women; building financially self-sufficient institutions; and ensuring a positive and measurable impact on the lives of clients and their families. The impact studies of micro-finance services claim that the programs have helped in reducing poverty, improving education and nutrition,

making housing conditions better, decreasing child mortality and enhancing the status of women.

Many governments including that of in Nepal, therefore, have adopted the micro-finance program as one of the major strategies to liberate the people from poverty. However, questions are raised as to whether the studies were conducted by an independent consultant/agency; whether the sample size was; sufficient; whether the products and services offered by Microfinance Institutions (MFIs) were able to help poor overcome poverty or to ameliorate the current problems of the poor; whether there is significant difference between villages with and without micro-finance services. They are major issues that the sector should provide clear insights into.

Microfinance practitioners, policy makers and professionals should internalize the queries and make necessary corrections in the program to show the world that MFIs are serious towards their mission in achieving the core themes prescribed by the industry. And we agree that we need to do much more work in collaboration to ensure that everyone, who are financially excluded, will have access to reliable and affordable financial services that can help improve their lives.

In the past, MFIs have been successful in achieving self-sufficiency, reaching the poor and establishing financial transparency. The future focus must be to provide quality financial and other support services. This requires maintaining transparency in pricing the products, developing products and services as per the needs of the poor people and establishing healthy business practices. Some people define micro-finance in a narrow sense as related to providing working capital loan for the “economically active poor”. But, in reality, every poor doesn’t require loan in order to stay alive or to smoothen his/her consumption needs. Savings is an important financial service to the poor. Savings service helps build thrift, smoothing consumption needs and building assets. Moreover, people living in extreme poverty need more than just financial services. They need a whole range of interventions from livelihood supports to business

development, financial education, health services, and the need to address other social issues responsible for increasing poverty.

The mission of micro-finance is achieved only if products and services are designed as per unique needs, opportunity and constraints of the local community. The standard products may not cater to the diverse needs of the community. The products offered by most of the MFIs currently fulfill the immediate need of the clients such as promoting small livelihood activities and smoothing consumption needs. Hence, the appropriate products with business development services should be provided to promote sustainable business and alleviate poverty.

The multi-dimensional approach has to be applied to address poverty. Only MFIs financial services do not address the global curse of poverty. This requires the partnership of MFIs, development organization, policy makers and the government. Components like financial and non-financial services, social performance management and information systems must be according to the context and nature of poverty. Therefore, rather than working in isolation, micro-finance programs should work hand-in-hand with the government and development programs to bring a greater impact on poverty. Different micro-finance methodologies are active in providing financial services to the poor; who are not served by conventional banking system. Some MFIs are more successful in reaching out to the poor and achieving financial sustainability, while others are more successful in promoting small and medium enterprises (SMEs), empowering the community and taking lead for overall development of the community.

The common citizens, businesses organizations, micro-finance institutions, government, donors/development organization, media and micro-finance clients should work together to promote sustainable growth and job creation and to help the poor people come out of poverty through improved financial services and other support services. We also need to promote and strengthen all micro-finance methodologies and institutions to reach those not reached by financial services.

Lastly, the clients of micro-finance and SME should be provided with money management skills and financial education related to budgeting, savings, rational use of available financial services and proper debt management for their meager resources.

A case on his study published in Real Times date 26 April 2011 of "Linking Health and Microfinance" by Somen Saha and Marcia Metcalfe. The provision of these services really does help to address concerns about the social value proposition of microfinance by improving both the financial health of the organization and its social performance. Adding health to microfinance and improving health and financial security for clients holds great potential for improving the overall health of indivi.

Reputation of microfinance has taken a hit in South Asia. Above, a prospective loan borrower reads a printed pledge by SKS Microfinance.

The microfinance industry, widely accepted as a model for poverty alleviation, is suddenly subjected to intense criticism, particularly in South Asia.

SKS and others have taken heat in the southern Indian state of Andhra Pradesh for allegedly shoddy practices and high interest rates while in Bangladesh the life-long work of Nobel laureate Muhammad Yunus has been described as entrapment of the poor into greater indebtedness.

Although the debate around regulating the microfinance sector is pertinent, blaming the entire sector will not only affect the lives of millions of poor served by the industry but also impede the tremendous potential that microfinance holds for allied causes like advancing universal health coverage in India.

In 2009, the microfinance industry in India was estimated to serve 81.7 million people. Annual credit demand by the poor in the country is estimated to be about 600 billion rupees but only about 20% of the rural poor are estimated to have access to microcredit. Along with access to credit, there will be a greater

reduction in poverty if microfinance programs can become a vehicle for advancing health coverage.

Out-of-pocket health expenditure increases poverty by as much as 3.6% and 2.9% for rural and urban India, respectively. Microfinance provides a promising platform to expand health access and coverage to workers in the informal economy through organized groups.

Most microfinance-assisted entrepreneurs are not part of the very poor, and are not employed in the organized sector. A portion of clients (one out of three new microfinance clients) are from urban backgrounds and reside in unauthorized colonies with limited access to basic health services.

This renders them vulnerable to poor health conditions and the financial shocks of illness. Not only can microfinance provide a platform for extending health coverage through India's national health insurance programs but they can facilitate increased access to health services through awareness generation, create linkages with healthcare providers, and provide other financing mechanisms such as health loans or health savings plans that can support or supplement health insurance programs.

Increasingly, microcredit banks are realizing that providing some kind of health coverage in tandem with loans is essential if they want to fulfill their mission to improve lives. Some of the benefits of integrating health services and microfinance include economic empowerment, social empowerment, and reduced gender disparity.

Adding health education alone, usually delivered during the routine scheduled microfinance group meetings, improves health knowledge that leads to measureable behavioral change associated with positive health outcome in diverse areas critically important to achieving the Millennium Development Goals in areas such as maternal and child health and infectious disease.

A demonstration project in India by Freedom from Hunger, where one of the authors works, showed that out-of-pocket expenses to offer health education and product distribution by a microfinance company in West Bengal amounted to \$0.17 per client per month, suggesting that microfinance firms can provide these service efficiently and at low cost with considerable value to clients.

About one quarter of Indian microfinance outfits offer some form of health services. These programs vary widely from small-scale health awareness programs to complex health interventions. However, despite islands of experiments in India to layer health protection services onto microfinance programs, only about 10% of existing microfinance clients have some access to health services.

There is some tension about whether microfinance outfits should concentrate in their core business of credit operation, or attempt to provide access to health services for clients. Questions linger like: How much does it cost to offer health services? Who will pay for access to health services? What services are best for clients' health needs? How will the products be designed?

Often microfinance firms struggle to design appropriate community-sensitive health programs. This underscores the necessity of building an effective technical capacity in program design and implementation. Some possible strategies include:

1. Establish a platform for microfinance firms, health practitioners, researchers and policy makers to share experiences and concerns that can lead to the development of a roadmap for advancing health coverage through microfinance in India.
2. Establish research and demonstration projects to help scale up integrated health and microfinance programs in India.

3. Establish dedicated inter-disciplinary centers to promote integrated health and microfinance programs in India.

\A case on his study published in the website ([www.muchbetteradventures.com](http://www.muchbetteradventures.com)) date 21<sup>st</sup> July, 2011 of “Responsible Microfinance is Alive and Well in Nepal” by Nayan Pokhrel: It’s becoming increasingly difficult to be an advocate for microfinance these days- not because financial inclusion for the poor is any less of an laudable goal, but because headlines and sound bites have picked up on negative anecdotal evidence and fail to examine the underlying causes for when microfinance might have failed some in certain situations.

This is not to say that exploitative or poorly executed microfinance programs with high interest rates and little financial counseling don’t exist, but they should not overshadow the success of well-planned initiatives.

Years before Muhammad Yunus was hailed as the father of microfinance, women throughout the developing world independently established financial tools as a means of survival in harsh economic climates, lending, saving and insuring one another against adversity. Economic analysis concludes that the poor must be more, not less, financially active than those in the developed world to combat risk and to maintain stability in a place with limited institutions.

Cautious microfinance remains an integral part of the OneSeed model . We believe that microfinance is neither a good or bad idea in and of itself, but rather a tool that can be leveraged to bring about meaningful change if it is implemented patiently and individualistically.

We believe in the power of for-profit enterprise to sustainably create opportunities for individuals to break the cycle of poverty. By providing no-interest capital to our trusted partner MFIs in Nepal through our revenue, we can guarantee a reliable source of funding for the small enterprises that are the lifeblood of the economy.

A case on his study published in 'Himalayan times' date 8<sup>th</sup> March, 2012 of "Microfinance Brings Major Changes" by Ajaya Bhadra Khanal: Until a few years back, locals at Baraha Village Development Committee (VDC) in Dailekh used to borrow from their wealthy neighbors insignificant amounts of loans.

But, at present, microfinance initiatives in the village have ushered in a significant shift to their plight. People's lives in the village have changed for the better after we started a group-based deposit and lending system, Saving Group in Baraha VDC."Microcredit has become very useful for the poor because now they do not have to visit moneylenders."

Most of the microfinance group in Baraha VDC offer very small loan to the poor, usually women, to help them expand their small-scale business or start new one, informed Prava Gurung who is also handling a savings group in the village. Local groups encourage farmers and women to save up to RS100 every month, according to her. They need it. "people in the village have realised that small amounts of saving can provide relief during adverse situation," she said." The savings are being utilised for micro entrepreneurship such as vegetable, bee and animal farming, along with solving other monetary problems of the locals." Obtaining loans from big for the poor, said Gurung, adding that they have to spend at least RS 5,000 for food and accommodation to receive a loan of RS 10,000 or even less because villagers have to go to the district headquarters to receive the loan.

"Generally, villagers do not need big amount of money to fulfill their needs," informed a member of Laligurans saving group Gurung Manishara Gurung."They need small amounts to fulfill their general needs such as to buy fertilisers, seeds or animal." So, it is not pragmatic for them to visit banks to get small amounts of loan, she said.

The interest charged on loans taken from local deposit groups is always significantly lower as compared to the rate charged by other credit sources like loan sharks and moneylenders, informed Gurung.

A case on his study published in Himalayan times date 8th march 2013 of "Sustaining micro finance" by khilendra Basnyat. Micro-finance rerefers to small-scale finance borrowed and mobilized by socially and economically disadvantaged poor, and the related activities thereafter. Beginning with the establishment of cooperative societies in 1956, the policies towards introducing micro-finance was brought during the 1960s wherein the concept of priority sector lending by the commercial banks was introduced.

The main objective of micro-finance, in the context of Nepal having rural agrarian economy, is to increase the enterprising/income-generating activities among the rural people by optimizing their access to micro-finance services. Actually, micro-finance aims at the economic empowerment of people and is more inclined towards social justice.

Micro-finance includes taking small-scale loan or micro-credit, generation and mobilization of savings by the micro-credit borrowers, carrying out income generation or micro enterprises by the consulting firms.

In addition to these components that compulsorily involves finance, various training given to the beneficiaries, literacy, health and other related programs are essential for micro-finance programs. Micro-entrepreneurship/ income generation activity is another component of micro-finance. Actually, money borrowed or saved does not produce anything if kept idle. Borrowed money or credit or loan must be repaid along with certain per cent of interest. For this, credit must be utilized in income generation activity in such a way that the return on the investment is greater than the interest. Moreover, savings should be properly utilized to ensure that the return is greater than the interest given by the bank or financial institutions. Insurance activity is another component of micro-finance because some fund is also generated and mobilized through the collection of insurance premium mainly on livestock production activities. In Nepal, there are some micro-finance programs and institutions targetting the

disadvantaged and poor people. There are some other institutions that are involved in micro-finance activities in the formal sector. The cooperatives have the objective of saving and providing credit.

Micro-finance programs are gaining popularity in Nepal; it is mainly due to the easy access to loans available at low interest without collateral. Also, the provision of group approach helps borrowers to exchange their ideas and share their problems, frequent meetings and women focused training programs have added attraction to the program. Moreover, efforts should be made to make them sustainable in the future.

### **2.12.2 Review of Some Previous Related Thesis & Dissertation**

There are some similar studies which had been conducted previously about Microfinance. The Micro Finance has very short history in Nepal. In country like Nepal, Microfinance Institutions have become one of the most important institutions in development policy. For this, some research studies are conducted on Microfinance.

A case study on “Micro credit for Women’s poverty Reduction” of the Ghaukhel VDC, Bhaktapur District, Nepal by Erika Gharana in 2001 is one of important study.

Woman in Nepal work for much longer hours, but the society does not take into account their share of productive. They are deprived of opportunities to participate in the main stream of development. The situation of women measured along the gender development index and gender empowerment measures does not look encouraging. Their level of literacy, life expectancy and income lies well below. Almost half of the people in the country live in unacceptable condition of poverty and majority of them are women.

Women are the important sources of energy for development and their groups can be an effective channel for resources aimed at meeting the needs of the poor

in rural areas. In past few years, there has been growing realization of the importance of women's participation in the development process and the need for the advancement. The study has found that overall impact of micro credit program for women on beneficiaries earning and living standards is positive. The program has also some positive social impact in terms of child education, family planning, sanitation and other social reforms. The involvement in the income generating activities has built up the self confidence of village women in their abilities. For example, literacy classes for women have made them to know about the skill relevant to bank and credit activities, such as how to sign their names and simple calculation regarding loan and interest. Such programs attempt to change the perception of women.

Another major study has been done by Kiran Ojha in 2002 on titled "Micro Finance Program on poverty Alleviation: A Socio economic Analysis." The study of co-operatives showed that micro finance program contributed in increasing the income of participating families. Families involved in micro finance program had new employment opportunities. The participating families were benefited as their income had increased and they had to pay fewer amounts as interest than the amount they used to borrow from local money lenders.

Literacy rate was not the determinant factor for any member to be involved in the micro finance program but the level of literacy seemed to determine their representation in the executive board directly. Participation of the women in group activities had increased their importance in their home as family member has started to consult them in household decision. The role of cooperative was very positive in creating a forum for women to participate in the social life. The cooperatives needed financial and management strengthening. However, the program has provisioned the financial services to the poor women in their doorstep, who would otherwise been excluded from these services.

In the study titled "Impact of Microfinance: A case study of micro credit program for women in Kahun Village Development Committee" by shantosh kumar Ghimire in 2005, financial sustainability of the program and effect of

training on living standard of the people was assessed. The objective set by Ghimire for this study was to measure the relationship between investment and income and to know the perception of users group towards the program.

Among four investment sectors of borrower, agriculture sector has highest investment. Businesses, which were started by taking loan from program, were found to be operating on regular basis. After the implementation of program, women were attracted towards economically profitable business like poultry farming, buffalo keeping and retail business. Correlation and regression analysis was found to be significant of women was positive. Likewise perception of users group towards the program was positive. Most of the participants had repaid the loan in due time.

Another study on “Micro Finance under Rural Development Program in Khilung Deurali VDC Syangja” by Aryal in 2007. The objective of the study was to know the activities operated under Rural Development Program, to analyze mode of loan of disbursement, repayment and saving deposit and its mobilization. In the study, he concluded that the program has provided loan for different sectors like, vegetable farming, livestock, cottage industry and small business. The overall performance of implementing Rural Development Program in target group, loan disbursement and training were found to be satisfactory.

A dissertation titled “Microfinance in Lekhnath Municipality: A case study of paschimachal Grameen Bikash Bank” by Rabindra Nath Poudel in 2007 is another important study relation to microfinance. The major finding of the study can be summarized as:

There are five different sectors of investment which are animal keeping, poultry farming, small scale industries and business like grocery shop, fresh house, cosmetics shop, fancy stores, hotel and restaurant, fruits and vegetable shop. After borrowing loan from micro finance institution, the average net income the existing business/occupation has been raised significantly.

There are 40 percent members of Brahmin/Chhetri, 10 Percent Newar, 29 Percent Gurung/Magar, 14 Percent of Dalit and 7 Percent miscellaneous ethical groups have been participated in the groups. Micro credit has been disbursed to each ethical group by 41 Percent, 11 Percent, 28 Percent, 14 Percent and 6 Percent respectively which makes clear that loan distribution among different ethnical groups has been almost in equal proportion with the proportion of different ethnical groups.

The study shows that micro credit provided by Paschimanchal Grameen Bikas Bank (PGBB) is being fruitful in terms of employment generation in the area but not as expected by bank. Similarly income generation due to micro credit is helpful for reduction of poverty from the income generation through new business/occupation established by bank loan but loan invested in the existing business occupation is not fruitful to alleviate poverty because such members who use loan to support existing business are not poor in terms of their income.

A study on “Financial Impact of child Labor Projects Micro Credit Program on Women in Kaski District” conducted by Manandhar in 2009. The basic objectives of the study were to measure the ratio of loan disbursement to repayment rate and to see women’s ability mobilize those funds properly and generate income. The research show that the fund was mobilized properly which is fruitful to generate significant income. In the mean time fund was mobilized to new occupation leaving traditional type of occupation after microfinance program was introduced. The overall performance of loan mobilization was fruitful for income generation.

### **2.13 Research Gap**

Many research studies have been conducted by the different students, experts, and researchers in the field of micro finance. There have been found numerous research studies of micro finance companies and NGOs. Some studies are related to the operational efficiency of the company, some have been done to analyze the role of the micro finance in poverty reduction, some are based on the individual company study and some on only women empowerment through

micro credit system but overall analysis of micro finance institution in macro level have been rarely found and its only in the short forms and seminar papers. No detail analysis has been done as it has been presented in this thesis research. From the review of the literature and related studies, no study has been found which represents the whole picture of problems and prospects of development of micro finance institution in Nepal.

This research includes different aspects of micro finance institution of Nepal to give the exact and confirmed information and clear cut position of the micro finance institution of Nepal and the problem and challenges that they are facing in general.

This research study made on a “problems and prospects of Development of micro finance institution in Nepal” will be an effort to analyze on some real problems and current prospects and positions of the micro finance institutions working in different sectors in Nepal. The study also will be helpful to future study and hope that can provide platform for understanding the various aspects of micro finance industry. The study has been conducted gathering, processing and analyzing the various data and facts provided and published by various institutions and organization in order to meet the objectives of the study.

The need of a comprehensive and analysis of problems and prospects of development of micro finance institution in Nepal a has been much felt and hope that this research can serve well and be helpful and beneficial to all the concerned parties, policy makers and students to carry future studies.

## **CHAPTER 3**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter serves the readers with a detail idea about how the research has been carried out. It includes the research design, research approach, data collection sources and the data analysis method. It also includes the referencing methods and the theories that had been used for conducting of the thesis. This chapter helps the reader to clearly understand how the research had been conducted.

#### **3.2 Research Design**

By research design we mean an overall framework of plan for the activities to be undertaken during the course of a research study. The research design servers as a framework for the study, guidingthe collection and analysis of the data, the research instruments to be utilized, and the sampling plan to be followed. Specifically speaking, research design describes the general plan for collecting, analyzing and evaluating data after identifying:

- ) What the researcher want to know?
- ) What has to be dealt with in order to obtain the required information?

According to Kerlinger (1986, p275): research design is the plan, structure, and strategy of investigation conceived so as to obtain answer to research questions and to control variance.

The objective of the study is to identify such programs which strengthen Micro Finance institutions to build up their institutional capacities to expand and sustain their operation in future and to identify the opportunities created by microfinance programs in poverty reduction and employment generation. A descriptive research method was adopted to make the study more considerable and intensive.

### **3.3 Sources of Data**

Only secondary data have been used for the study purpose. The necessary data and information are collected from various sources covering the period of five years. The sources of secondary data are various websites, research report, survey report, theses, dissertations, annual reports, workshop report.

### **3.4 Sampling procedures**

As described above, the study has been made being based on the microfinance institutions which are registered to rural Microfinance development center, Nepal. Rural Macro finance development Centre: an apex micro finance institution in Nepal which provides wholesale credit to other micro finance institution and has played very important guardianrole for the development and growth of micro finance institutions in the country. Depending upon the financial data those institutions published by RMDC, the study hope to give the picture of viability of micro finance in Nepal and its existing trends and future prospects. All the dataare taken from the reports prepared by RMDC, Nepal and thus the secondary data are used for study and research purpose.

### **3.5 Methods of Data Analysis**

The data collected from different sources are classified and tabulated in a simple way. The data is organized and analyzed in descriptive way without using any complex model or statistical tools. Analysis has been for all data collected from different sources in descriptive approach. Tables, charts and bar diagrams are used to simplify the presentation. All data and information are edited and coded by computer in spreadsheets.

### **3.6 Reliability and Validity of Data**

Data are considered to be valid when they measure what they are supposed to measure. Similarly reliability is a sign that whatever the researcher has attempted to measure would give the same results even if more samples were surveyed.

Since the data were collected only through secondary sources, reliability and validity of data depends upon the authenticity of the data published by the concerned sources.

### **3.7 Necessary Tools and Technique**

The study has been done in the form of descriptive methods of data analysis. No complex statistical formulae and tools have been used while doing the research work. Analysis has been done for all data collected from different sources in descriptive approach. Tables, Charts and bar diagrams are used to simplify the presentation. All data and information are edited and coded by computer in spreadsheets.

## **CHAPTER -4**

### **DATA PRESENTATION AND ANALYSIS**

In this chapter the data collected are tabulated, analyzed and presented in a reasonable and wise manner. The concern is given into presentation and analysis part in detail. As data presentation and analysis is crucial part of any research, purpose is to organize collected data to assure an easy and understandable presentation. So, for each and every research work the important of this chapter is most. Because on the basis of this analysis made on chapter findings are obtained. Based on those findings recommendations have been derived and future guidelines are got. It is so obvious that the presentation of the data and its analysis help us to draw valid conclusion.

#### **4.1 Poverty Alleviating Role Played by MFIs in Nepal**

Each year since 1990 the Human Development Report has published the human development Report has published the human development index (HDI) which looks beyond GDP to a broader definition of well-being. The HDI provides a composite measure of three dimensions of human development: living a long and healthy life (measure by life expectancy), being educated (measured by adult literacy and gross enrolment in education) and having a decent standard of living (measured by purchasing power parity, PPP, income). The index is not in any sense a comprehensive measure of human development. It does not, for example, include important indicators such as gender or income inequality nor more difficult to measure concepts like respect for human rights and political freedoms. What it does provide is a broadened prism for viewing human progress and the complex relationship between income and well being.

Of the components of the HDI, only income and gross enrolment are somewhat responsive to short term policy changes. For that reason, it is important to examine changes in the human development index over time. The human development index trends tell an important story in that respect. Between 1980 and 2007 Nepal's HDI rose by 2.16 percent annually from 0.309 to 0.458 today. HDI scores in

all reasons have increased progressively over the years (Figure1) although all have experienced periods of slower growth or even reversals.

According to Human Development Report 2013, the HDI for Nepal is 0.463 which gives the country a rank of 157 out of 182 countries.

The HDI measures the average progress of a country in human development. The Human poverty index (HPI-1) focuses in the proportion of people below certain threshold levels in each of dimensions of the human development index- living a long and healthy life, having access to education, and a decent standard of living. By looking beyond income deprivation, the HPI-1 represents a multi-dimensional alternative to the \$1.25 a day (PPP) US\$) poverty measure.

The HPI-1 value of 32.1 Present for Nepal, ranks 99<sup>th</sup> among 135 countries for which the index has been calculated.

**Table No. 4.1**  
**Nepal's Human Development Index 2013**

HDI value	Life expectancy at birth (Years)	Adult literacy rate (Percent ages 15 and above)	Combined gross enrolment ratio (Percent)	GDP per capita (PPP US\$)
1. Norway (0.945)	1. Monaco (89.73)	1. Cuba (99.9)	1. Australia (114.2)	1. Qatar (1, 02,943)
92. Srilanka (0.715)	Srilanka (75%)	148. Angola (70.00)	134. India (61.00)	srilanka (5170)
156. Nigeria (0.459)	133. The Bahamas (65.78)	149. Laos (68.70)	135. Morocco (61.00)	161. Rwanda (1,341)
<b>157.Nepal (0.463)</b>	<b>134. Nepal (69.1)</b>	<b>150. Nepal (68.20)</b>	<b>136. Nepal (60.90)</b>	<b>162. Nepal (1137)</b>
158. Haiti (0.454)	135. Tajikistan (65.33)	151. Cameroon (67.90)	137. Swaziland (60.10)	163. Burma (1,325)
159. Mauritania (0.453)	136. Pakistan (64.49)	152. Congo (66.80)	138. Kenya (59.60)	164. Uganda (1,317)
187. Congo (0.286)	191. Swaziland (31.88)	183. Mali (26.20)	177. Djibouti (25.50)	183. Congo (348)

Source: Human Development Reports- UNDP

The table no. 4.1 (HP-1) measures savers deprivation in health by the proportion of people who are not expected to survive to age 40. Education is measure by the

adult illiteracy rate. And a decent standard of living is measured by the unweighted average of people not using an improved water source and the proportion of children under age 5 who are underweight for their age. Table 4.2 shows the values for these variables for Nepal and compares them to other countries.

**Table No. 4.2**  
**Selected Indicators of Human Poverty for Nepal**

<b>Human Poverty index (HPI)</b>	<b>Probability of not Surviving to age 40 (percentage)</b>	<b>Adult illiteracy rate (percentage 15 and above)</b>	<b>People not Using improved Water sources (percent)</b>	<b>Children underweight for Age (percent aged Under 5)</b>
1. Czech Republic (1.5)	1. Hong Kong, China (SAR) (1.4)	1.Georgia(0.0)	1.Barbados (0)	1.Croatia (1)
97. Haiti (31.5)	88.Uzbekistan (10.7)	128.Yemen (41.1)	71. Venezuela (Bolivarian Republic of)(10)	125. Pakistan (38)
98.Equatorial Guinea (31.9)	89. El Salvador (10.7)	129.Papua New Guinea (42.20)	72.Occupied Palestinian (11)	126. Ethiopia (38)
<b>99.Nepal (32.1)</b>	<b>90.Nepal (11.0)</b>	<b>130. Nepal (43.5)</b>	<b>73.Nepal(11)</b>	<b>127. Nepal (39)</b>
100. Rwanda (32.9)	91. Kazakhstan (11.2)	131.Mauritania (44.2)	74.Kyrgyzstan(11)	128. Burundi (39)
101.Pakistan (33.4)	92. Guatemala (11.2)	132.Morocco (44.4)	75.Syrian Arab Republic(11)	129. Afghanistan (39)
135. Afghanistan (59.8)	153.Lesotho (47.4)	151. Mali(73.8)	150.Afghanistan (78)	138. Bangladesh (48)

Source: Human Development Report-UNDP

Both human development index and poverty index indicate that Nepal ranks among the lowest of all countries in terms of human living standard and poverty reduction rate. The main reasons for this low poverty reduction rate are: (1) low per capital income, (2) concentrated urban growth and (3) high Population Growth rate. Out of 23 million, 38 percent are in below poverty line. Most of the people live in rural areas and have little opportunities. They do not have easy access to financial services from formal sources. Access to financial services, such as loans, saving services, insurance and money transfer enable to increase

income and smooth consumption flows, thus expanding their assets base and increasing their ability to respond to the crises. The availability of financial services acts as a buffer against sudden emergencies, business risk and seasonal slumps that can push a family into destitution. Since low income people are often ineligible for traditional financial services, micro finance specifically targets low income groups. As a development tool it is believed that these services available to poor households can help them to move from mere subsistence for daily survival to planning for the future and investing in better nutrition, improved living conditions, and children's health education.

## **4.2 Micro Credit Programs**

The micro credit programs, as in order countries, have created significant impact on the lives of beneficiary families in the country. A study on the impact of micro credit program on the clients and their families shows that:

- ) The reliability on money lender and relatives has decreased significantly.
- ) There was substantial increase in cash income and average saving among the beneficiary household.
- ) The beneficiary clients have added assets like radio, television, utensils, gold ornaments and furniture substantially.
- ) There is a gradual shift form houses of thatched roofing to tiled and corrugated and to RCC among the majority of the clients.
- ) The land holding size of the clients has also increased.
- ) Food self sufficiency for 12 month from own regular production and income has improved.
- ) There are significant changes observed in the use of drinking water and sanitary toilets.
- ) Almost all the clients are sending their school going age children to schools.
- ) There have been huge changes in social aspects. For example. Participation of women in community works has increased, and respect to women from their family members and society has increased.

Poverty constitutes the main challenges and problem of Nepal's economic development. According to the Tenth plan (2002-2007), the magnitude of poverty rampant in the destitute class is about 38 percent of the total population (80.6million people) whereas the preliminary report (2004/2005) of a recent survey relating to measurement of living standards has shown that the percentage of poverty in Nepal has declined to 30.8 percent. The term "destitute class" means the class of people with a per capita income amounting to the annual average of Rs 4404 that is about 60US dollars (at 1995prices). As a huge section of the country's population is in a state of destitution, the need has been clearly felt for helping through microfinance the efforts to achieve the national objectives of gradually reducing the country's destitution by promoting capital formation and generating self-confidence among the people belonging to this class and thus raising their socio economic standard through small scale savings and income generation, employment oriented and vocational programs.

In this context, the process of institutionally supply credit to the destitute class through commercial banks was initiated in Baishak, 2013 (April/May, 1974) through the small sectors credit program (Priority Sector Credit Program). In 2031(1974), the Nepal Rastra Bank directed commercial banks to invest on a mandatory basis 5 percent of their total deposits [currently, a specific portion of the total credit;4 percent for the fiscal year 2061/2062 (2004/2005)] in such priority sectors as agriculture, cottage industries and services enterprises and the destitute class. The flow of credit to this sector began thereafter. From the seventh plan period (2032) (1975), the Agricultural Development Bank started providing financial services to the destitute class by supplying them with micro-credit through the small farmers development program. Since then, the institutional credit program started moving ahead. Now that it has been announced that the priority sector credit system will be totally removed with effect from the last day of Ashad, 2064 (July 15, 2007) even while maintaining the provision of investing three percent of the total credit in the destitute class, the issue of making investments in this sector has become an issue of voluntary

decision for commercial banks. It is, therefore necessary to improve the system of supplying credit to the rural sector.

### **4.3 Outreach of Micro Finance Institutions in Nepal**

Over the past 20 years Nepal's financial sector has become deeper and the number and type of financial intermediaries have grown rapidly. In addition, recent reforms have made banks more stable. Still, access to financial services remains limited for many people in many parts of Nepal. For much of the past 50 years Nepal's government has tried to increase access to formal financial services for small businesses and low-income households. The government has introduced directed lending programs for small businesses and low-income households, required banks to open branches outside the Kathmandu valley, created specialized wholesale and retail institutions, and lowest market entry requirements to fosters, access to formal financial services is declining. Despite government efforts, access to formal financial services is declining. Financial intermediation is stagnating, the number of bank deposit and loan accounts per inhabitant is falling, and lending targets for low-income households have generated excess liquidity among microfinance institutions without significantly increasing their outreach. And despite 40 year of government mandates to lend to small businesses, banks have been withdrawing from this segment as these requirements have been lowered. Access to bank infrastructure has also decreased. Nepal Rastra Bank created the Rural Self -Reliance Fund in 1990 to supply funds to microfinance institutions. It also provides financing to development banks involved in national priority areas, such as tea growing and processing. The Rural Self-Reliance Fund makes loans to financial cooperatives and financial NGOs at an annual interest rate of 8 percent, with the provision that three- quarters of the interest on principle be repaid on time. Loan tenors are three years, and institutions are only eligible for three loans-the first for NRs 1.0 million, the second for NRs1.5 million, and the third for NRs 2.5 millions. The fund provides longer-term loans to development banks and government and Nepal Rastra Bank have given it nearly NRs 340 million in grant capital yet only

a bit more than half has been used for lending. In January 2010 outstanding loans to financial cooperatives and financial NGOs totaled NRs25 million (NRs 22 million for the cooperatives and NRs 3 million for the NGOs), to the Agricultural Development Bank, NRs 92 million, and to regional rural developments banks, NRs 15 million. Total outstanding loans were NRs190 million.

**Table 4.3**  
**Types of Retail Micro Finance Institution Regulated**

<b>Type of Institute</b>	<b>Total Number</b>	<b>Number Regulated</b>	<b>Number of Loans From Regulated Institutions</b>
Financial Cooperative	About 2,300 FINGOs and 190 SFCs	20	28,000
FINGO	15,000	47	39,000
MFDB	4	4	104,000
RRDB	5	5	190,000

Source: Access to Financial Services in Nepal, 2069

Table 4.3 shows only 49 percent of Nepalese households have a deposit account with any financial institutions. There is high presence of NGOs and cooperatives in the Far and Mid Western and Eastern region and the low presence of these institutions in the Western and Central regions. (such institutions served 29.8 percent of households in Eastern region, 13.14 percent in Central region, 3.9 percent in Western region and 26.4 percent in Far and Mid Western region). Household in the Central Western regions had the highest shares of Households with accounts in banks and finance companies and available themselves of several financial services.

32percent of households did not have access to any kind of credit. Only 15 percent had access to credit from formal sources. 37 percent of household borrowed from informal sources. Household from Eastern and Central region had higher access to credit than other regions. Micro Finance Development Banks and Regional Rural Development Banks especially serve the rural areas

of the country. People from rural areas get credit especially from FINGOs and cooperatives. But existence of informal lending is high in rural areas.

**Table 4.4**  
**Household Access to Bank Account by Administrative Region**  
**(In Percent)**

Region	No. Account	Bank	Finance Company	MFDB or RRDB	FINGO or Cooperative	Multiple Accounts
Eastern	41.5	14.3	0.7	5.4	29.8	8.2
Central	57.1	20.2	1.8	2.6	13.4	5.0
Western	61.8	26.5	0.5	4.8	3.9	2.5
Far and Mid	39.5	22.0	0.0	2.8	26.4	8.4
<b>Average</b>	<b>51.0</b>	<b>20.4</b>	<b>0.9</b>	<b>3.9</b>	<b>17.9</b>	<b>5.9</b>

Source: Access to Financial Services in Nepal, 2069

**Table 4.5**  
**Household Access to Bank Accounts in Urban and Rural Areas**  
**(In Percent)**

Area	No Account	Bank	Finance Company	MFDB or RRDB	FINGO or Cooperative	Multiple Accounts
Kathmandu Lalitpur	23.8	50.5	9.5	1.0	2.4	12.9
Other Areas	27.1	43.3	3.3	1.0	12.9	12.3
Rural	55.4	15.9	0.2	4.4	19.3	4.7
<b>Average</b>	<b>51.0</b>	<b>20.4</b>	<b>0.9</b>	<b>3.9</b>	<b>17.9</b>	<b>5.9</b>

Source: Access to Financial Services in Nepal, 2069

Table 4.4 and 4.5 depicts the fact that financial NGOs and cooperatives are the largest providers of household loans under NRs 10000 which account for 90 percent of the total. Even households with bank accounts borrow mainly from financial NGOs and cooperatives for loan under NRs 50000. These institutions seem to be preferred over other providers because they are faster at issuing loan (11 days once all required documents have been provided), require physical collateral only for just 38 percent of loans, and more readily accept movable collateral (53 percent of loans with collateral are collateralized with movable assets).

**Table 4.6**  
**Household Access to Bank Accounts by Agro Climatic Region**  
**(In percent)**

<b>Region</b>	<b>No Account</b>	<b>Bank</b>	<b>Finance Company</b>	<b>MFDB or RRDB</b>	<b>FINGO or Cooperative</b>	<b>Multiple Accounts</b>
Terai	48.8	21.3	0.4	7.1	17.5	4.9
Hill Mountains	56.0	16.6	0.9	0.1	19.7	6.7
Kathmandu Lalitpur	23.8	50.5	9.5	1.0	2.4	12.9
<b>Average</b>	<b>51.0</b>	<b>20.4</b>	<b>0.9</b>	<b>3.9</b>	<b>17.9</b>	<b>5.9</b>

Source: Access to Financial Service in Nepal, 2069

**Table 4.7**  
**Household With and Without Credit Administrative Region**  
**(In percent)**

<b>Region</b>	<b>None</b>	<b>Formal Only</b>	<b>Informal Only</b>	<b>Both</b>
Eastern	26.4	17.6	30.8	25.2
Central	40.1	14.6	38.5	6.8
Western	25.2	13.7	51.7	9.4
Far and mid	30.2	13.8	29.3	26.6
<b>Average</b>	<b>32.1</b>	<b>15.0</b>	<b>37.5</b>	<b>15.5</b>

Source: Access to Financial Services in Nepal, 2069

Table no. 4.6 and 4.7 shows that financial NGOs and cooperatives are the largest providers of household loans under NRs 10000 which account for 90 percent of the total. Even households with bank accounts borrow mainly from financial NGOs and cooperatives for loans under NRs 50000. These institutions seem to be preferred over other providers because they are faster at issuing loans (11 days once all required documents have been provided), require physical collateral only for just 38 percent of loans, and more readily accept movable collateral (53 percent of loans with collateral are collateralized with movable assets).

**Table 4.8**  
**Household With and Without Credit in Urban and Rural Areas**  
**(In Percent)**

<b>Area</b>	<b>None</b>	<b>Formal Only</b>	<b>Informal Only</b>	<b>Both</b>
Urban	43.4	18.3	26.0	12.3
Rural	30.0	14.4	39.6	16.0
<b>Average</b>	<b>32.1</b>	<b>15.0</b>	<b>37.5</b>	<b>15.5</b>

Source: Access to Financial Services in Nepal, 2069

**Table 4.9**  
**Household With and Without Credit by Argo Climatic Region**  
**(In Percent)**

<b>Area</b>	<b>None</b>	<b>Formal Only</b>	<b>Informal Only</b>	<b>Both</b>
Terai	27.8	19.7	32.8	19.6
Hills & Mountains	34.8	8.8	45.5	10.9
Kathmandu	63.8	14.8	15.2	6.2
<b>Average</b>	<b>32.1</b>	<b>15.0</b>	<b>37.5</b>	<b>15.5</b>

Source: Access to Financial Services in Nepal, 2069

Banks are the largest provider of formal credit serving 45 percent of household with a loan from a formal financial institution. Banks tend to serve urban areas and wealthiest households. Banks are the largest provider of loans larger than NRs 50000. Microfinance, Development Banks and Regional Rural Development Banks serve only 11 percent of households with formal loans. These institutions mainly serve clients for loan under NRs 50000. Microfinance institutions play a key role in providing financial services to low income households. Yet many microfinance clients prefer to save and borrow.

**Table 4.10**  
**Household with Credit from Formal Institutions in Urban and Rural Areas**  
**(In Percent)**

<b>Areas</b>	<b>Bank</b>	<b>Finance Company</b>	<b>MFDB or RRDB</b>	<b>FINGO or Cooperative</b>
Kathmandu & Lalitpur	43.2	43.2	4.5	9.1
Other Urban	56.1	9.6	10.0	24.3
Rural	31.7	1.4	22.4	44.6
<b>Average</b>	<b>35.1</b>	<b>3.4</b>	<b>20.4</b>	<b>41.1</b>

Source: Access to Financial Services in Nepal, 2069

**Table 4.11**  
**Small Business Loans by Type of Lending Institutions and Loan Size (In Percent)**

<b>Loan Size(NRs)</b>	<b>Bank</b>	<b>Finance Company</b>	<b>MFDB or RRDB</b>	<b>FINGO or Cooperative</b>
Less than 10,000	0.0	9.7	0.0	90.3
10,000-50,000	19.2	16.7	25.6	38.5
50,001-100,000	17.3	9.9	0.0	19.8
100,001-250,000	68.9	26.4	0.0	4.7
250,001-500,000	67.1	25.7	0.0	7.2
More than 500,000	94.7	5.3	0.0	0.0
<b>Average</b>	<b>45.5</b>	<b>17.8</b>	<b>11.5</b>	<b>25.2</b>

Source: Access to Financial Services in Nepal, 2069

According to table no. 4.10 and 4.11 with the informal sector, Financial NGOs and Cooperatives, followed by microfinance development banks and regional rural development banks are the largest providers of financial services for low income households. Still, many microfinance clients prefer to use the informal sector for deposit and loan. The reason is that informal providers offer to use the informal sector for deposits and loan. The reason is that informal providers offer products and services better suited to the needs of low-income household—that is, with quick availability and no requirement for immovable collateral. Low-income household are much more likely than wealthier ones to have irregular income. In addition, many of their non-routine expenditures are for health care. Thus they often require quick access to financial resources. Moreover, half of Nepal’s low-income household cannot use their homes as collateral because they do not have the required documents and because their dwellings are in a bad area, in poor condition, or both. Informal providers better serve the needs of such clients by offering faster service and requiring no collateral. Moreover, less than 10 percent of informal loans are secured with collateral, compared with 64 percent of formal ones. The limited ability of formal microfinance institutions to adequately serve low-income households is reflected in their poor outreach, institutions represents only the tip of the iceberg of Nepal’s microfinance sector, they are broadly representative of the sector—if not better performing.

#### 4.4 Demand, Supply and Loan able Fund of Rural Credit in Nepal

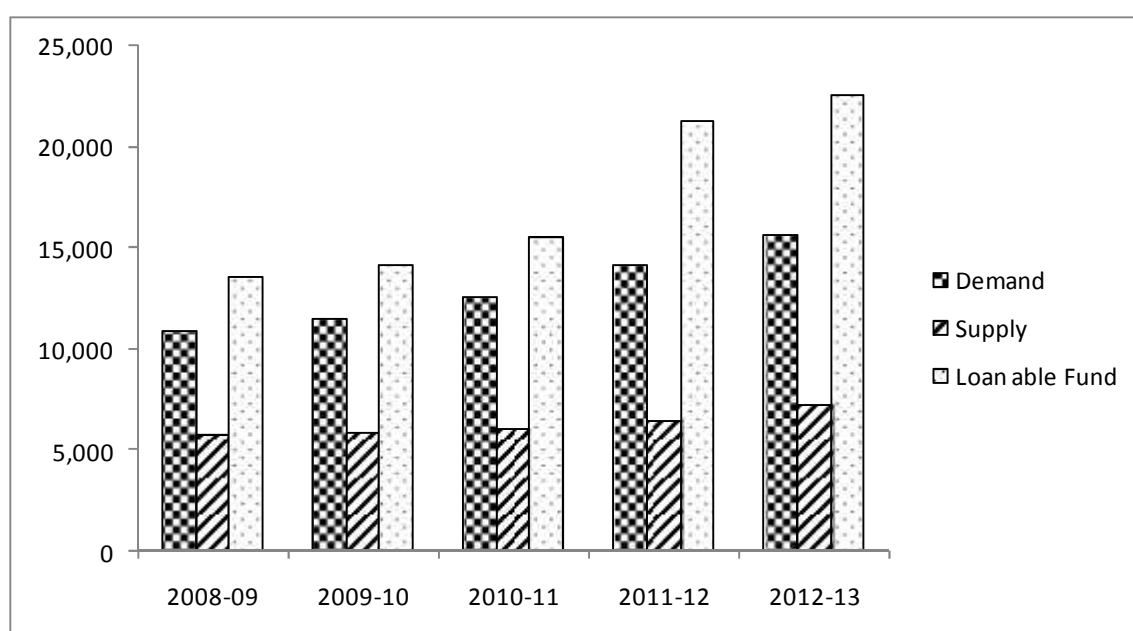
The study made by Nepal Rastra bank on Nepal Rural credit review survey has found out the total Rural Credit demand, institutional credit supply and loan able fund based on the price index. The research reveals the fact that the credit supply is much less than the credit demand even though the loan able fund is comparatively much higher. The table and charts reveals that the credit supply is much less than the credit demand even though the loan able fund is comparatively much higher in successive years.

**Table No. 4.12**  
**Demand, Supply and Loan able Fund of Rural Credit in Nepal (Million)**

FY	Demand	Supply	Supply/Demand (%)	Loan able Fund	Demand/Loan able Fund (%)
2008-09	10,877	5813	53.44	13,567	80.17
2009-10	11,465	5898	51.44	14,188	80.81
2010-11	12,632	6053	47.92	15,549	81.24
2011-12	14,217	6465	45.48	21,308	66.72
2012-13	15,616	7283	46.64	22,583	69.15

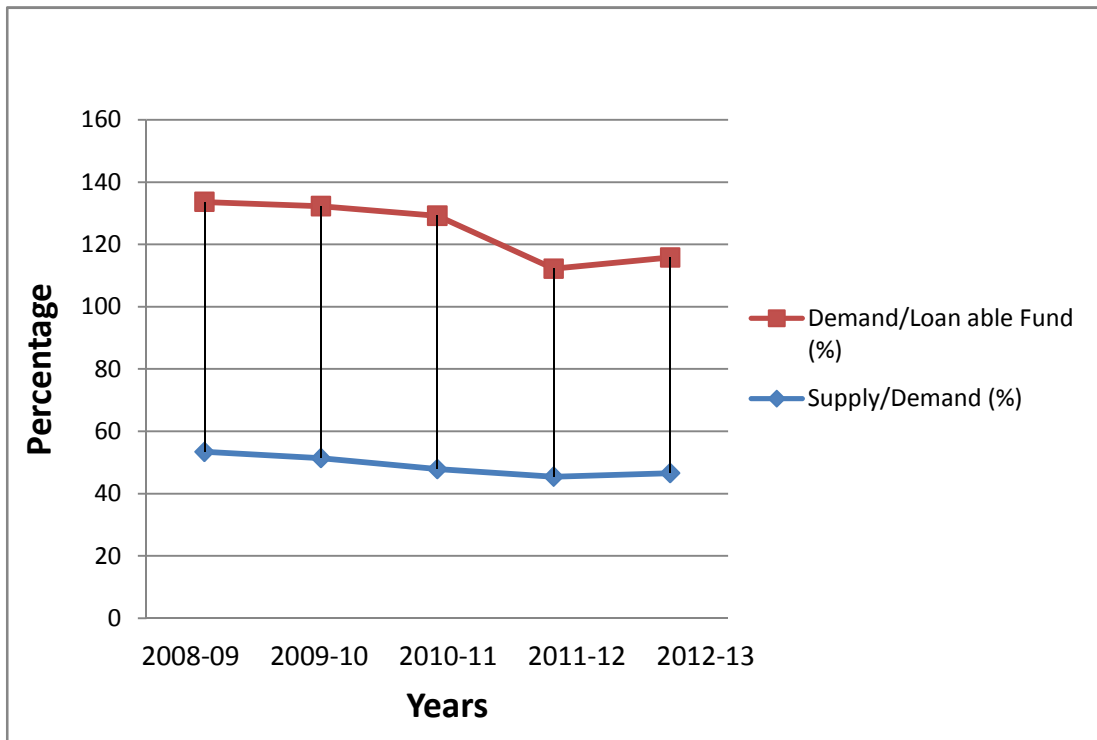
Source: Nepal Rastra Bank, 2013

**Figure 4.1**  
**Demand, Supply and Loan able Fund**



**Figure 4.2**

**Demand, Supply and Loan able Fund in %**



Above table no. 4.12 and figures 4.1 & 4.2 show that the credit demands in the FY2008/09 as 10877 million whereas the credit supply was only Rs 5813 million. 53.44% and the loan able fund was Rs. 13567 million. In the same way the table and charts depicts that in FY2012/2013 the credit demand was Rs. 15616 million, credit supply was Rs 7283 million 46.64% and the loan able fund was Rs 22583 million. The demand for the credit is in increasing trend where as the supply seems to be reluctant though the loan able fund is very much higher and in increasing trend. The percentage of supply to credit demand is decreasing each Year. In the FY 2008/09 it was 53.44% which came to 51.44%,47.92%,45.48% and 46.64% subsequently in the FY 2009/10,2010/11,2011/12 and 2012/2013. Whereas the demand to loan able and charts reveals that the credit supply is much less than the credit demands even though the loan able fund is comparatively much higher in successive year.

## 4.5 Micro Finance Project

The history of formal micro credit programs and projects in Nepal started with small farmer's development programs (SFDP) of ADB. SFDP has partly been transformed into small farmer's cooperative ltd. This program was followed by priority sector lending programs (PSLP), Intensive Banking program (IBP), Production Credit for Rural Programs (PCRW), Rural Self Reliant Fund (RSRF) and many others programs and projects were implemented by the various institutions and banks in different periods.

The mission of these programs is to open avenues for the flow of formal micro credit services for income generating activities for the rural sector where the majority of the population are below poverty. Among the programs some have completed their term, some have discontinued and some are still continuing. Some of the major programs and projects are as follows:

**Table 4.13**  
**Micro Finance Programs and Projects**

S.N	Programs/ Projects	Operation Years	Responsible Institutions
1.	Small Farmers Development program	1975	ADB/N
2.	Priority Sector Lending Program	1973-2007	CBs
3.	Deprived Sector Credit program	1990	CBs
4.	Women Empowerment	1981	GON
5.	Bisheshwor with the Poor	1982-1998	GON
6.	Lead Bank Scheme	1988	NRB
7.	Banking With The poor	1991	RBB
8.	Women Awareness and Income Generation Program	1999	GON
9.	Poverty Alleviation Fund Program	2000	NRB
10.	Cottage and Small Industry Programs	1982	GON
11.	Rural Self Reliance Fund	1991	NRB
12.	Third Livestock Development Projects	1996	GON
13.	Poverty Alleviation Project In Western Terai	2000	GON
14.	Community Group Water Irrigation Sector Project	2001-2006	GON

Source: NRB, 2013

## 4.6 No. of MFIs Operating and No. of District Covered

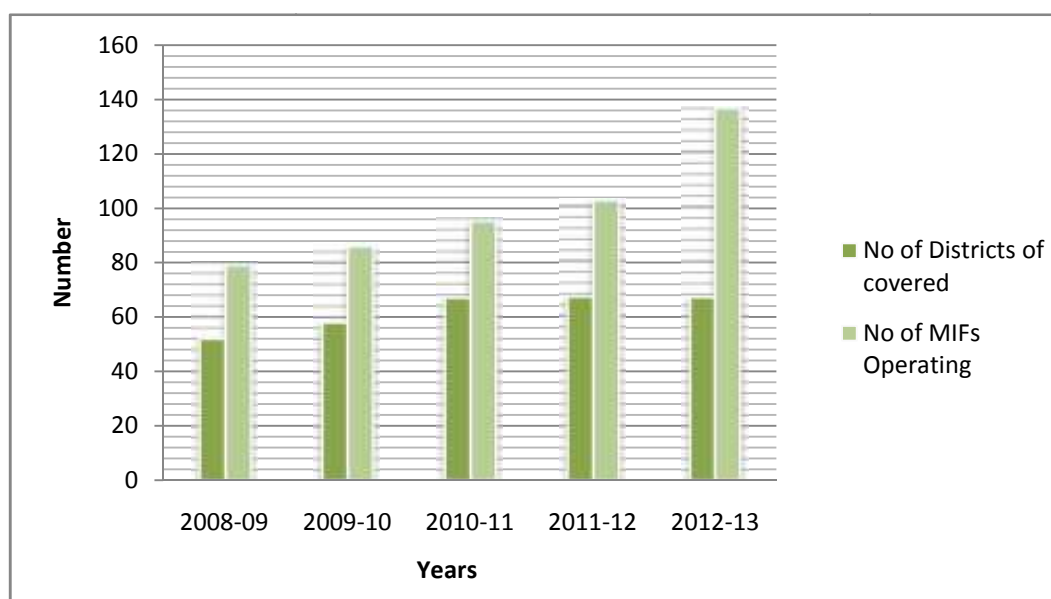
The Microfinance Institutions in Nepal are not operating in its full capacity and level to provide services to the rural areas, deprived sector and class. Most of the microfinance institutions seem unwilling to expand to the rural areas and are concentrated in the urban and town.

**Table No. 4.14**  
**No. of Districts covered and No. of MFIs operating**

FY	No. of Districts covered	No. of MIFs Operating
2008-09	52	79
2009-10	58	86
2010-11	67	95
2011-12	67	102
2012-13	67	136

Source: Rural Microfinance Development Centre (RMDC)

**Figure 4.3**  
**No. of Districts covered and No. of MFIs operating**



From analysis of table 4.14 and figure 4.3 it can be depicted that the MFIs in Nepal is not operating to whole nation though its increasing each year. By FY2012/13 the no. of institution has reached up to 136 but the total district covered the MFIs is only 67. Remaining 8 districts of the nation is still out of the microfinance services. In the FY2010-11 the no. of district covered by the MFIs

was 52 which came to 67 by the FY 2012/13 followed by the 58 in 2009-10, 52 in 2008/07, and 67 in 2011/12. There is growth in No. but Institution seems reluctant to expand to the deprived rural areas. In the FY2010-11 the number MFIs were 67 coming to the end of the FY 2012/13 reached to 136, increasing each year subsequently.

#### 4.7 No. of Staffs and Clients Trained in MFIs in Nepal

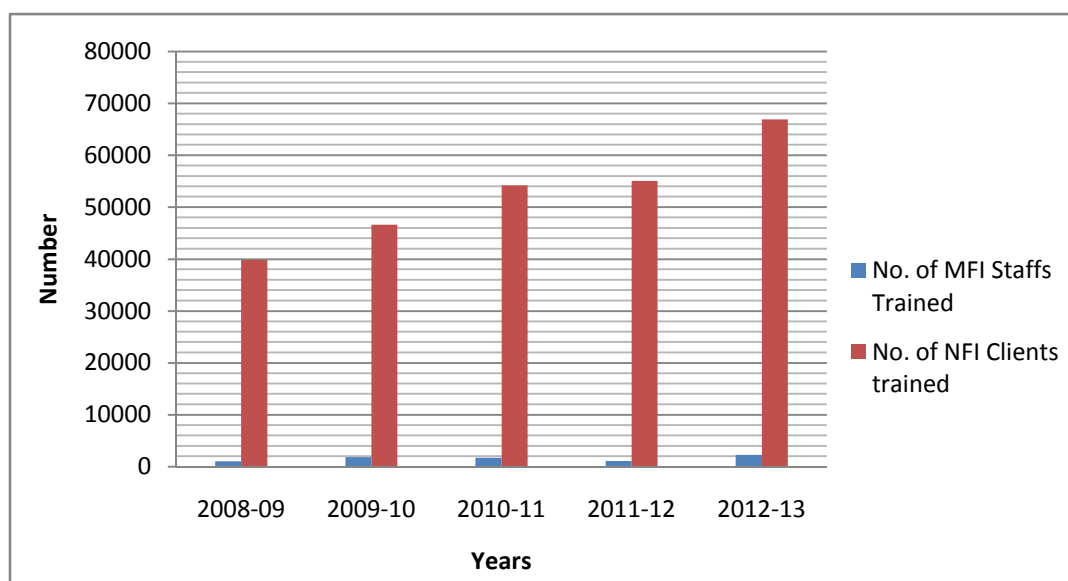
Sufficient and adequate training to the Staffs and the Clients to increase the productivity, efficiency and effectiveness of the organization. Following table and chart depicts the status and level of No. of staffs and clients trained in MFIs in Nepal.

**Table No. 4.15**  
**No. of Staffs and Clients Trained in MFIs in Nepals**

<b>FY</b>	<b>No. of MFI Staffs Trained</b>	<b>No. of NFI Clientstrained</b>
2008-09	1021	39839
2009-10	1845	46616
2010-11	1728	54246
2011-12	1133	55110
2012-13	2306	66947

Source: Rural Microfinance Development Centre (RMDC)

**Figure 4.4**  
**No. of Staffs and Clients Trained**



It is very necessary to provide sufficient and adequate training to the staffs and the clients to increase the productivity, efficiency and effectiveness of the organization. Training enhances awareness and knowledge of the people. In microfinance industry it is rather important due to its nature of the job. Analyzing the above data of table 4.15 and figure 4.4, we can extract the fact that in MFIs in Nepal, the no. of staffs and clients trained is growing satisfactory in each successive year. In the FY2010-11 the no of staff trained was 1021 with the no. of MFIs being 67 where the no. of MFI client Trained was 39839. The no. of staff trained grown up to 2306 in FY 2012/13 where the no. of MFI operating is 136 having no. of client trained to 66947. The trend is positive and provides good signal to the development of the industry.

#### **4.8 No. of Savers and Borrowers in MFIs in Nepal**

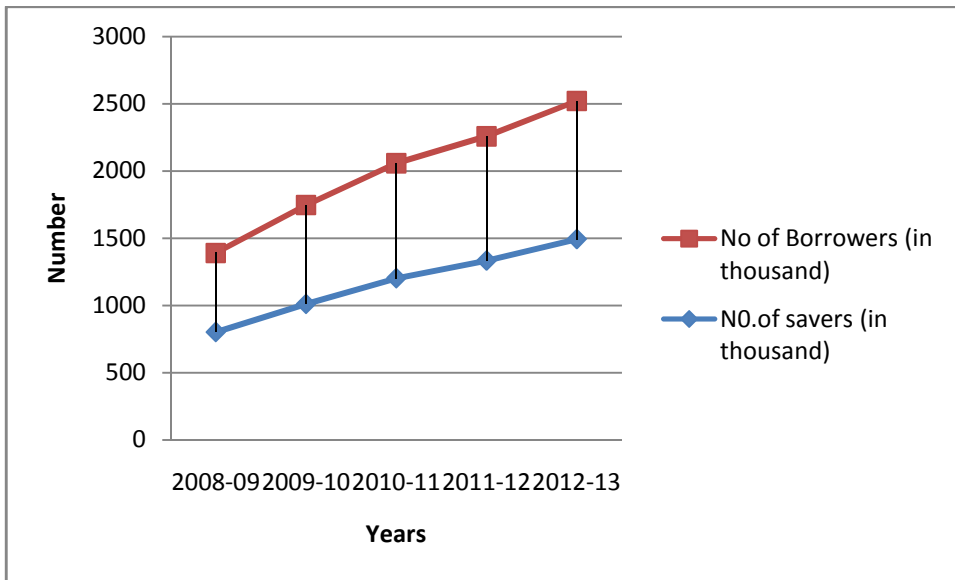
Each year the no. of savers in MFIs in Nepal is increasing rapidly which is very good indicator in the field of its development and future potentiality increment. With this, the trend of the no. of borrowers the mobilization of collected to the users and the needy people and sectors that enhances economic activities.

**Table 4.16**  
**No of Savers and Borrowers in MFIs in Nepal (in thousand)**

FY	No of Savers	No of Borrowers
2008-09	802	589
2009-10	1011	736
2010-11	1202	856
2011-12	1333	925
2012-13	1493	1028

Source: Rural Microfinance Development Centre (RMDC)

**Figure 4.5**  
**No. of Savers and Borrowers**



Analyzing table no.4.16 and figure 4.5, the fact can be concluded is each year the no. of savers in MFIs in Nepal is Increasing rapidly which is very good indicator in the field of its development and future potentiality increment. With this, the trend of the no. of borrowers is also tend to increasing which indicates the mobilization of collected fund to the users and the need people and sectors that enhances economic activities. In the FY2010-11 the total no. of savers was 802 which came to 1493 in the FY 2012/13 followed by 1011 in the FY 2011-12, 1202 in the FY 20010/11 and 1333 in the FY 2011/12. The total no. of borrowers also has increased to 1493 in the FY2012/13 which was only 304030. The trend of the both borrowers and savers seems to have positive impact on resource mobilization and development of both MFIs and the people.

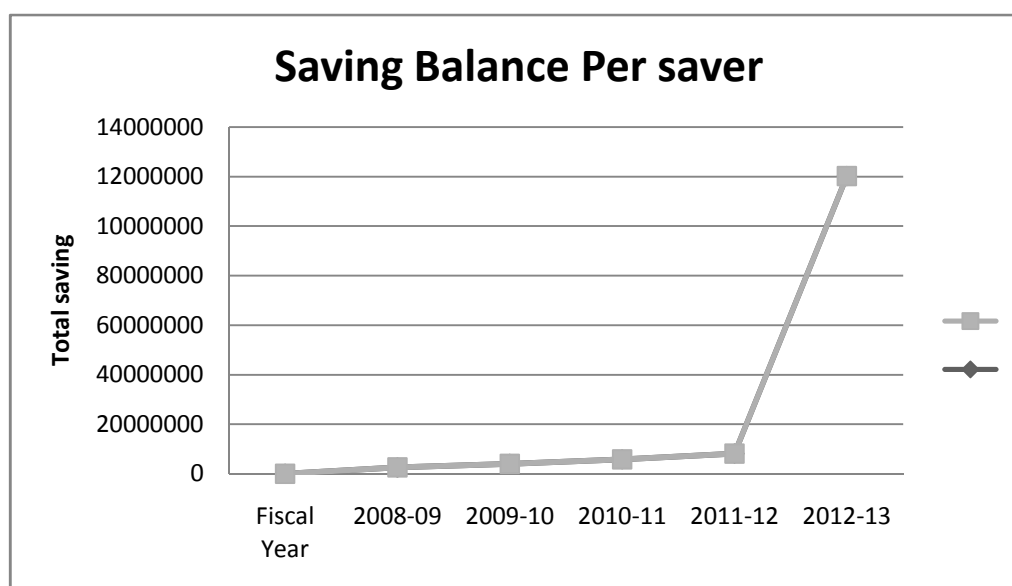
## 4.9 Total Savings and Saving Balance per saver

Total Saving and Saving Balance per saver are as shown below. These table and chart reveals the fact that the total saving of the saver in Nepal growing each year in increasing trend. It also depicts the fact that the interest of people toward MFIs

**Table 4.17**  
**Total Savings and Saving Balance per saver**

Fiscal Year	Total saving (in 000)	saving Balance per sever (In 000)
2008-09	2,528,000.00	3,153.00
2009-10	3,859,000.00	3,916.00
2010-11	5,795,416.00	4,820.00
2011-12	8,127,907.00	6,099.00
2012-13	12,014,694.00	8,048.00

Source: Rural Microfinance Development Centre (RMDC)



is increasing which is good for the sake of the industry. Table 4.17 and figure 4.6 and 4.7 reveals the fact that the total saving of the MFIs in Nepal is growing each year in increasing trend. It also depicts the fact that the interest of people toward MFIs is increasing which is good for the sake of the industry. In the FY2008-09 total saving was Rs.1064086 (In 000) which rose to Rs.1680530 (in 000) in the FY 2009-10, Rs. 2499091(In000) by the FY 2010-11, and Rs.3953538 (In 000) by the FY 2011-12 and finally has come to Rs.5790000 (In 000) by the FY 2012-13. Saving balance per saver (IAR) is also increasing in increasing trend. In the FY2006/0 it was Rs. 2113(in 000) which reached to Rs.4800(In000) followed by Rs.2516(In 000) in the FY 2009-10, Rs.3117 (in 000) in the FY 2010-11, Rs.3901(in 000) in the FY 2011-12. Both total saving and the total saving per MFI (IAR) during the study period of 2008-09 to the FY2012-13 has provided favorable single to the industry.

#### **4.10 Borrower to Savers Ratio of MFIs of Nepal**

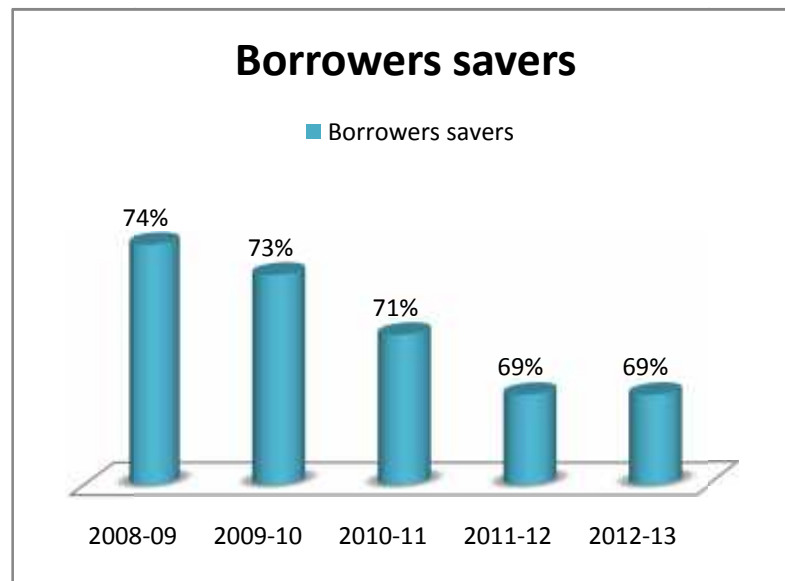
Borrower to savers ratio in the MFIs in Nepal is in Decreasing trend which from one side is in the favour of the industry since there will be sufficient liquidity to meet organizations liabilities and contingencies, from another side it show the decreasing pattern in loan mobilization system that result in negative favour to the growth and development of the MFIs.

**Table No. 4.18**  
**Borrower to Savers Ratio of MFIs of Nepal**

<b>Fiscal Year</b>	<b>Borrowers to savers Ratio in %</b>
2008-09	74%
2009-10	73%
2010-11	71%
2011-12	69%
2012-13	69%

Source: Rural Microfinance Development Centre (RMDC)

**Figure 4.8**  
**Borrower to Savers Ratio in %**



Analyzing above figure and data on table 4.18 and figure 4.8 it can depicted that the borrower to savers ratio in the MFIs in Nepal is in Decreasing trend which from one side is in the favour of the industry since there will be sufficient liquidity to meet organizations mobilization system that result in negative favour to the growth and development of the MFIs. In the FY208/09 it was 74%, which came down to 69% by the FY2012/13 followed by 73% in the FY2011-12, 71% in the FY 2012-13 and 69% in the FY 2011/12. The trend has mix impact to the industry and there are enough opportunities to expand its services to deprived rural areas.

## 4.11 Total Loan Disbursed, Recovered & Outstanding in MFIs in Nepal

The total loan disbursed, recovered and outstanding in micro finance institutions have been presented in table below:

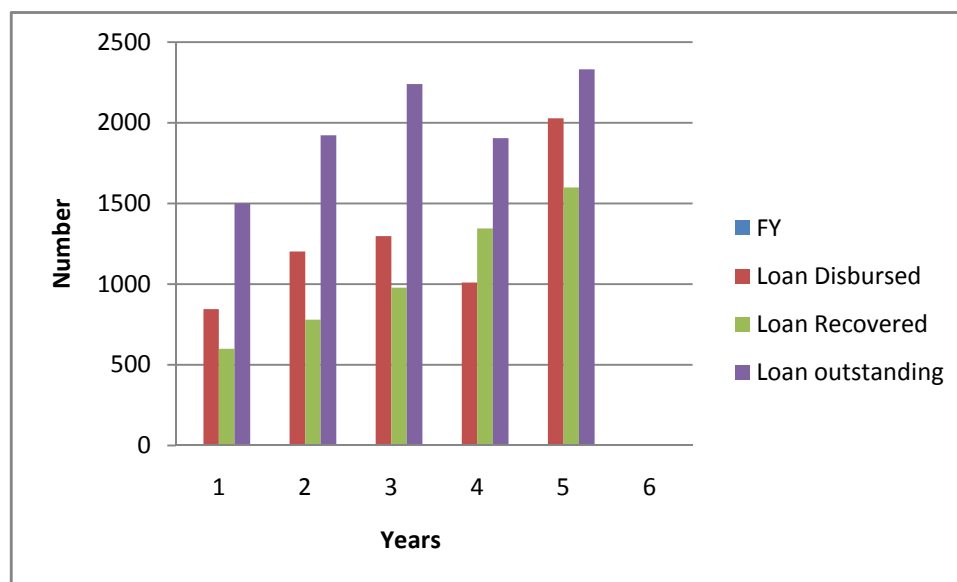
**Table No. 4.19**  
**Total Loan Disbursed, Recovered & Outstanding (Rs. in Millions)**

Source: Rural Microfinance Development Centre (RMDC)

FY	Loan Disbursed	Loan Recovered	Loan outstanding
2008-09	845	600	1500
2009-10	1202	780	1922
2010-11	1298	979	2241
2011-12	1009	1345	1905
2012-13	2027	1600	2332

**Figure 4.9**

**Total Loan Disbursed Recovered and outstanding (Rs. In Million)**



Above table 4.19 and figure 4.9 reflect the status and the trend of total loan disbursed, recovered and the loan outstanding of MFIs in Nepal during the study period. Total loan disbursed is increasing in increasing in increasing trend. In the FY 2010-11 total loan provide was Rs. 845 (In 000) which after then went to Rs. 2027 (In 000) in the FY 2012/13 followed by the Rs. 1202(In 000) in the FY 2011-12, Rs 1298 (In 000) in the FY2012-13, and Rs.1009 (In 000) in the FY 2011/12. Meanwhile the total loan recovered is also in increasing trend during the study period of the FY 2010-11 to FY 2012/13. In the FY 2010-11 it was Rs. 600 (In 000) which reached to Rs. 1600(In 000) by the FY2012/13. The total loan outstanding is growing each year but it does not mean that the MFIs are not operating well, since the total loan amount has been increasing heavily. In the FY 2010-11 total loan outstanding was Rs. 1500 (In 000) coming further to the FY 2011/12 it is Rs. 2332 (In 000) where as the total loan disbursed in the FY 2010-11 was Rs. 845 (In 000) and Rs.2027 (In 000) in the FY 2012/13. Comparatively the trend of the loan outstanding ratio is decreasing.

#### **4.12 Loan Overdue to Total Loan Disbursed Ratio of MFIs in Nepal**

The loan overdue trend of microfinance institutions in Nepal is fluctuating and now is in improving tread which is a positive sign for the health of MFIs in Nepal .It represent the reliability of its clients toward the institution as it is getting strength slowly. Clients are building their faith to microfinance industry that reducing default rate and helping to grow the microfinance sectors.

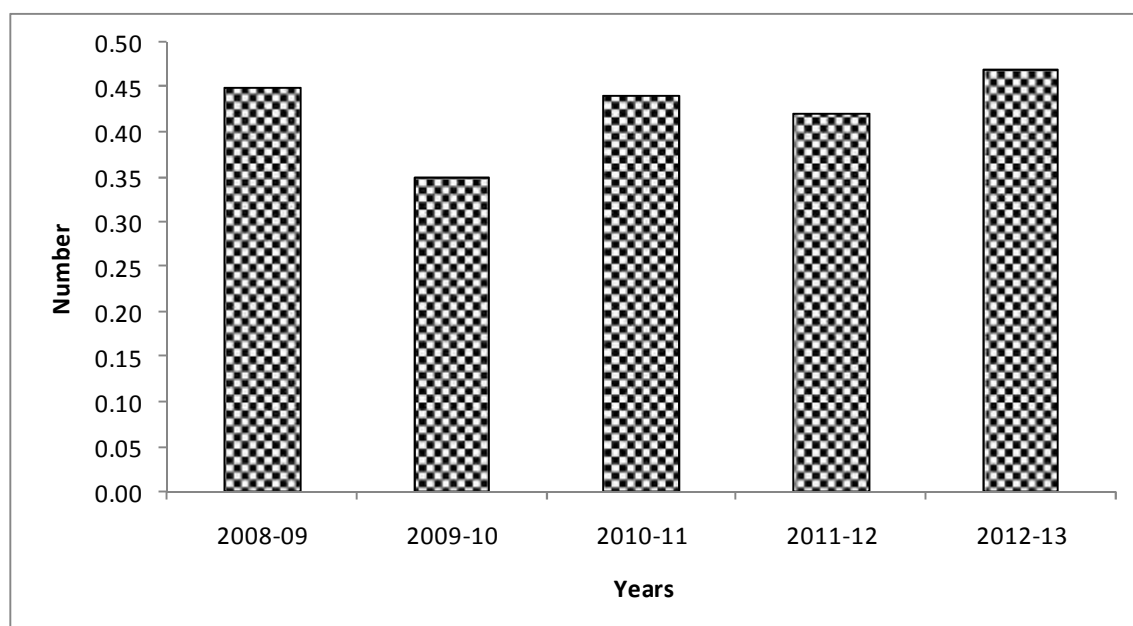
**Table 4.20**  
**Loan Overdue to Total Loan Disbursed Ratio of MFIs in Nepal**

<b>FY</b>	<b>Loan Overdue to Total Loan Disbursed Ratio in %</b>
2008-09	0.45
2009-10	0.35
2010-11	0.44
2011-12	0.42
2012-13	0.47

Source: Rural Microfinance Development Centre (RMDC)

**Figure 4.10**

**Loan Overdue to Total Loan Disbursed Ratio in %**



From the analysis of above table 4.20 and figure 4.10 it can be concluded that the loan overdue trend of microfinance institution in Nepal is fluctuating and now is in improving trend which is a positive sign for the health of MFIs in Nepal. It represents the reliability of its clients towards the institution as it is getting strength slowly. In the FY 2010-11 the overdue ratio was 0.44% which rose to 0.42% in the FY 2011-12 and slowly decreasing it came down to 0.47% in the FY 2010-13. It reflects that the clients are building their faith to microfinance industry that reducing default rate and helping to grow the microfinance sector.

### **4.13 Saving to Loan Outstanding Ratio in MFIs in Nepal**

It is very crucial to keep balance between assets and loan, In MFI it is saving and loan. If it is not balance then the MFIs cannot operate smoothly, effectively and efficiently. Saving to total loan outstanding ratio provides the clear map to meet the requirement of its liabilities and helps to keep the maintenance of the liquidity.

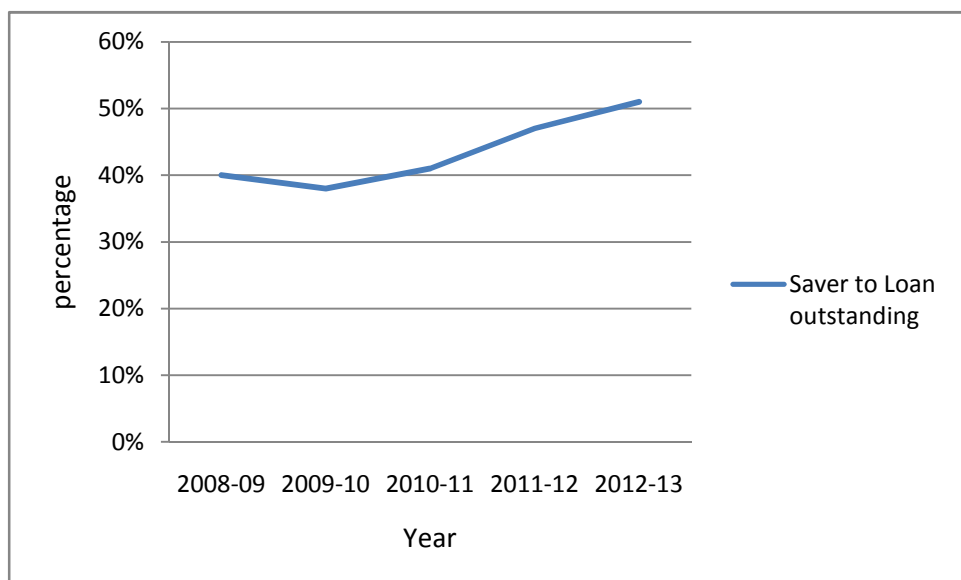
**Table no. 4.21**  
**Saving to Loan Outstanding Ratio in MFIs in Nepal**

<b>Fiscal Year</b>	<b>Borrowers savers</b>
2008-09	40%
2009-10	38%
2010-11	41%
2011-12	47%
2012-13	51%

Source: Rural Microfinance Development Centre (RMDC)

**Figure 4.11**

**Saving to Loan Outstanding Ratio in Percentage**



It is very crucial to keep balance between assets and loan, In MFI it is saving and loan. If it is not balanced then the MFIs cannot operate smoothly, effectively and efficiently. Table 4.21 and figure 4.11 clearly show that saving to total loan outstanding ratio provides the clear map to meet the requirement of its liabilities and helps to keep the maintenance of the liquidity. In the FY 2010-11 the saving to loan outstanding ratio is 40% which comes to 51% in the FY 2012/13 following 38% in the FY 2011-12, 41% in the FY 2012-13 and 47% in the FY

2011/12. The trend is fluctuating but is in safe level of matching its liabilities (Clients saving).

#### **4.15 Major Findings of the Study**

The major findings of the study on “problems and Prospects of Development of Micro Finance Institutions in Nepal” during the five Years study period has been summarized below:

- According to Human Development Report 2013, the HDI for Nepal is 0.463 which gives the country a rank of 157<sup>th</sup> out of 182 countries.
- The proportion of people of who are not expected to survive to age 40. Education is measured by the adult illiteracy rate. And a decent standard of living is measured by the unweighted average of people not using an improved water source and the proportion of children under age 5 who are underweight for their age. Table 2 the value for these variables for Nepal and compares them to other countries.
- Only 49 percent of Nepalese household have a deposit account with any financial institutions. There is high presence of NGOs and cooperatives in the Far and Mid-Western and Eastern region and the low presence of these institutions in the Western and Central regions.
- Half of Nepal’s low-income households cannot use their homes as collateral because they do not have the required documents and because their dwellings are in a bad area, in poor condition, or both. Informal provider better serve the needs of such clients by offering faster service and requiring no collateral. Moreover, less than 10 percent of informal loans are secured with collateral, compared with 64 percent of formal ones. The limited ability of formal microfinance institutions to adequately sever low-income households is reflected in their poor outreach, sluggish growth, high liquidity, and low profitability. Although regulated microfinance institutions represent only the iceberg of Nepal’s

microfinance sector, they are broadly representative of the sector – if not better performing.

- The demand for the credit is in increasing trend where as the supply seems to be reluctant though the loan able fund is very much higher and in increasing trend. The percentage of supply to credit demand is decreasing each year. In the FY2008-09 it was 53.44% which came to 51.44%,47.92%,45.48% and 46.64% subsequently in the FY2009-10,2008/2009,2011-12,and 2012-13. Whereas the demand to loan able fund was increasing till 2011-12and came down to 69.15% in the year 2010/10. The table and charts reveal that the credit supply is much less than the credit demand even though the loan able fund is comparatively much higher in successive years.
- From above analysis it can be depicted that the MFIs in Nepal is not operating to whole nation though its increasing each year. There is growth in number but institution seems reluctant to expand to the deprived rural areas. In the FY2010-11 the No. of MFIs was 79 coming to the end of the FY2012/13 reached to 136, increasing each year subsequently.
- We can extract the fact that in MFIs in Nepal, the no. of staffs and clients trained is growing satisfactory in each successive year. In the FY2008-09 the no of staff trained was 1021 with the no. of MFIs being 79 whereas the no. of MFI client trained was 39839. The no. of staff trained grown up to 2306 in FY 2012/13 whereas the no.of MFI operating is 136 having no. of client trained to 66947. The trend is positive and provides good signal to the development of the industry.
- Each year the no. of savers in MFIs in Nepal is Increasing rapidly which is very good indicator in the field of its development and future potentiality increment. With this, the trend of the no. of borrowers is also trend to increasing which indicates the mobilization of collected fund to the users and the needy people and sectors that enhances economic activities. The trend of the both borrowers and savers seems to have

positive impact on resources mobilization and development of both MFIs and the people.

- The total saving of the savers in Nepal is growing each year in increasing trend. It also depicts the fact that the interest of people toward MFIs is increasing which is good for the sake of the industry. Both total saving and the total saving per savers (IAR) during the study period of 2010-11 to the FY 2012/13 has provided favorable signals to the industry.
- It can be depicted that the borrower to savers ratio in the MFIs in Nepal is in Decreasing trend which from one side is in the favor of the industry since there will be sufficient liquidity to meet organizations liabilities and contingencies, from another side it shows the decreasing pattern in loan mobilization system that result in negative favor to the growth and development of the MFIs. In the FY2008-09 it was 77%, which came down to 71% by the FY 2012-13 followed by 76% in the FY2009-10, 74% in the year FY2008/2009 and 73% in the FY 2012-13. The trend has mix impact to the industry and there are enough opportunities to expand its services to deprived rural areas.
- The total loan outstanding is growing each year but it does not mean that the MFIs are not operating well, since the total loan amount has been increasing heavily. In the FY 2008/2009 total loan outstanding was Rs.1500 (In millions) coming further to the FY 2012/13 it is Rs.2332 (In millions) where as the total loan disbursed in the FY 2010-11 was Rs.845 (In millions) and Rs.2027 (In millions) in the FY 2012/13. Comparatively the trend of the loan outstanding ratio is decreasing.
- The loan overdue trend of microfinance institutions in Nepal is fluctuating and now is in improving trend which is a positive sign for the health of MFIs in Nepal. It represents the reliability of its clients towards the institution as it is getting strength slowly. In the FY 2010-11 the overdue ratio was 0.77 which rose to 0.55 in the FY2011-12 and slowly decreasing it came down to 0.44 in the FY 2012/13. It reflects that the

client are building their faith to microfinance industry that educing default rate and helping to grow the microfinance sectors.

- Saving to total loan outstanding ratio provides the clear map to meet the requirement of its liabilities and help to keep the maintenance of the liquidity. In the FY 2010-11 the saving to loan outstanding ratio 40% which come to 51% in the FY 2012/13 following 38% in the FY 2011-12 41% in the FY 2012-13 and 47%in the FY2011/12. The trend is fluctuating but is in safe level of matching its liabilities (Clients Savings).

## **CHAPTER-5**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

This chapter summarizes the research findings presented in Chapter Four and their theoretical and managerial implications. This chapter also includes the recommendation to correct some aspects need to develop Micro finance in Nepal.

#### **5.1 Summary**

Nepal has a history of implementation of microfinance programs for more than three decades. During this period, a large number of microfinance institutions have emerged with government, non government and donor initiatives .Growth in the number of MFIs has positive as well as negative implications. The growth in number of MFIs can help the expansion of outreach, the sustainability of these institutions and growth of assets which, in its own turn, can help reduce operating costs. The darker sides are that rapid expansion of portfolio can increase loan arrears and losses, increase the cost of monitoring or may result in oversight of borrowers' and thus less effective prevention of default and it can generate inconsistencies between the large size and rapid expansion of operations, on the one hand, and, on the other hand, existing organizational structure, the skill of available human resources, etc. But so far no comprehensive assessments have yet been done to enhance our understanding on these. Likewise, the impact of MFIs operations on the economy remains un-assessed.

Microfinance institution of Nepal has disbursed substantial amount of funds to the poor households through retail MFIs till date. It has been able to maintain and improve the living stands of the people living in rural areas and deprived of basic physical needs. The major reasons behind the growth on its performance is because loan programs are need based capacity building supports to and close monitoring and supervision. Promotions and development of MFIs has been one of the major roles of this institution from the very beginning of its operations.

The bank has emerged as the largest microfinance bank in Nepal in terms of clients outreach. During the period clients living below the line of poverty were having easy access to financial service at their door steps from bank through its 3840 centers operated under 58 branch offices. It has been able to satisfy the financial needs of poor people and its services includes micro-credit, saving, insurance and remittances services.

Because of the political instability in the country, company's transactions were adversely affected. Its staffs could not be freely mobilized in eastern and mid-Terai region which affected the center business and credit discipline.

The absence of commercial banks in most of the rural parts of the country and the inability of the small farmers to get credit in times of need provided room to these non conventional forms of lending MFIs are one of these major type of institutions that have not only achieved a degree of success but they have also managed to attract donor support. There are several reasons for this. Macro Finance System is generally characterized by relatively small loans and easily available at their doorstep. The risk involved in lending money without collateral is overcome by giving the customer good incentive to repay their loans. The repayment period is relatively short. The repayment rate is quite high, which is attributed to the informal participatory structure which makes debtors aware of their obligation. Regular meeting reinforce a culture of discipline, repayments and staff accountability.

Fragmentary studies show that participant of such programs usually have higher and more stable income than they did before they joined the program. The implementation of microfinance programs for several years in Nepal has demonstrated that given the opportunity, the poor is capable of making best use of scarce resources, generate good income and repay the loan in time.

Micro-finance programs not only give women and men access to saving and credit, but reach millions of people worldwide bringing them together regularly in organized groups. Although no 'magic bullet', they are potentially a very

significant contribution to gender equality and women's empowerment, as well as pro-poor development and civil society strengthening. Through their contribution to women's ability to earn an income these programs have potential to initiate a series of 'virtuous spirals' of economic empowerment, increased well-being for women and their families and wider social and political empowerment. Micro finance services and groups involving men also have potential to question and significantly change men's attitudes and behaviors as essential components of achieving gender equality.

Such MFIs Programs are also providing necessary training to their clients for strengthening their group and improving their entrepreneurial and income generating skills. The training programs may include adult literacy and non formal education, gender sensitization, group development, leadership development, entrepreneurial and occupational skills development.

Micro finance Services are helpful to the poor to enable them to finance specific private income generating activities to increase their income. However it is essentially important to make sure that the loan facilities provided are not utilized for consumption purposes. If the actions of such borrower are imitated by other poor people, then it could produce negative impact on the future growth of microfinance. Several factors explain the poor state of the formal microfinance sector in Nepal, including the complicated geo-political environment, weak technical capacity, lack of commercial orientation, and distortion arising from deprived sector lending policies. These factors affect the sector's profitability and are discussed below:

#### **Complicated Geo political Environment:**

The geo-political environment of Nepal—a mountainous country that has been experiencing conflict in recent Year—poses significant challenges. The performance of many small farmers' cooperatives and financial NGOs and cooperatives has been severely affected by the insurgency. The conflict has affected all formal microfinance providers, though to different degrees

depending on their location and ownership structure. Although Microfinance development banks have faced difficulties, they have been able to keep looting under control by maintaining good relations with clients and with insurgents in their areas. Regional rural development banks are perceived by the general public as being government institutions, making them particularly vulnerable to the insurgency. As a result their operations have been badly affected. These banks have experienced frequent thefts of cash, physical threats to their employees, and damages to their properties. To mitigate risks, microfinance providers have developed a number of strategies, including minimizing cash transfers and disbursing loans immediately after collecting repayments. Microfinance providers have also spent time explaining to Maoists that their microfinance activities benefit the population.

**Weak Technical capacity:**

Formal microfinance institutions suffer from capacity in key technical areas such as accounting and auditing, strategic planning, financial analysis, and human resource management. The weak technical capacity clearly slows the sector's growth. Most microfinance providers face similar challenges: a lack of professionally trained staff in technical areas, weak internal control systems, no internal or external audit mechanisms, inadequate management information systems, and low capacity for product development. Although the Rural Microfinance Development Center has provided crucial capacity building and "hand holding" support to its borrower, it has limited sources for such activities. Significant additional efforts are required to build capacity in the sector—both for providers of technical assistance to microfinance providers and for the sector itself.

**Lack of commercial Orientation:**

Lack of commercial orientation and slow professionalization of the sector hamper its profitability; many still consider microfinance a charitable activity. By design, NGOs do not have a commercial orientation. In addition, they tend to

have weak governance structure, due to lack of clear ownership. That is why the NGOs legal form is inappropriate for providing to evolve into strong microfinance. Accordingly, many NGOs in other countries aiming to evolve into strong microfinance institution have chosen to transform themselves into companies.

This transformation has also occurred in Nepal with the creation of NirdhanUtthan Bank Limited, the Development Project Service Center Development Bank, ChhimekBikas Bank, and SwambalambanBikas Bank from their respective NGOs. Government ownership of the five regional rural development banks also undermined their commercial orientation (which explains efforts to privatize them. Similarly, the four private microfinance development banks do not have a strong commercial orientation.

#### **Distortions Arising from Deprived Sector lending policies:**

Deprived sector lending has led to high liquidity and distorted capital adequacy ratios among formal microfinance institution .The balance sheet of Nepal's licensed microfinance providers have extremely high levels of liquidity, with investments and liquid funds accounting for more than 20% of assets in all these institutions. This situation is particularly striking for

Microfinance and regional rural development bank (with this figure approaching 40% and financial NGOs , (with this figure approaching 50 %).This high level of liquidity is matched by high loans ,which account for more than 60% of liabilities for financial NGOs ,regional rural development bank ,and microfinance Development bank .(In contrast ,loans represent only 2.5% of liabilities for financial cooperatives .)Not surprisingly the Rural Self-reliance Fund has large non disbursed among of loans, while the Rural Microfinance Development Center has committed the fullamount available only after nice years of operations. Such high levels of liquidity and loans are a result of the deprived sector lending window. In some cases, because commercial banks are uncertain about the capacity of some microfinance providers they lend to, they

ask the providers to invest these low-cost funds (with annual interest rates of 3-5 percent rate margin is usually 2-3 percent. In other cases commercial banks trust microfinance provider to on lend the fund, but the provider might not have the retail capacity to do so.

Deprived sector lending also has a perverse effect on the capital adequacy ratios of microfinance providers, because it inflates the ratio for institutions (particularly financial NGOs) that receive high levels of deprived lending and entrust these funds to banks or financial companies instead of on lending them to their clients.

### **Low Profitability:**

These various obstacles translate into low profitability in the formal microfinance sector. In 2005 only of 20 financial co-operatives and 4 of 47 financial NGOs recorded profits over NRs 1 million. And despite Nepal Rastra Bank's reform program, just two of the five regional rural development banks made a profit only due to income its investments in deprived sector lending by other financial institutions.

## **5.2 Conclusion**

During the implementation of microfinance programs since some three decades, the majority of the poor is still left out of institutional microfinance services. Such programs have only limited Impact in terms of increasing the outreach of microfinance to the poor. The total population of Nepal is estimated to be around 21.11 million in 20013, of which around 23 percent are the ultra poor. Living in hills, mountains and interior areas of the terai have no access to institutional microfinance services. More than 77 percent of the total poor families still depend upon informal sources to meet their credit need or have no access to any source of credit at all. Majority of prospective clients –Nepal's rural women population below poverty line-still remain un-served from MFIs programs or

Have Several operational problems can be listed. However, some important ones can be listed below:

**Restriction on Savings Mobilization:**

Saving mobilization is an essential ingredient of the microfinance system, as it expands resource base of an MFIs, inculcates ownership of people on the institutions and lessens dependency on external fund for expansion of credit programs. Besides, it helps customers in managing their liquidity in emergencies and for household consumption. The financial Intermediary Act 1988(FIA) has restricted an MFI to mobilize saving even from its own members. This probably needs correction.

**Weak Financial Viability and Sustainability of MFIs:**

Most of the MFIs are running in loss and have failed to attain operational self sufficiency even after several years of operation. They are suffering from staff productivity and high operation cost.

**Poor Governance and Weak Institutional Capacity:**

Most of the MFIs are characterized by poor governance, unprofessional management and weak institution capacity. These organizations are yet to be managed like business organization with realistic business plans, effective monitoring and supervision systems, and auditing and control systems.

Associated with these operational problems, some of the key issues and challenges that need to be addressed through appropriated policy measures are:

**Limits to the use of credit as an instrument of poverty alleviation:**

There are limits to the use of credit alone as an instrument for poverty eradication, including difficulties in identifying the poor and targeting credit to reach the poorest of the poor. Added to this is the fact that many people, especially the poorest of the poor, are not usually in the position to undertake an

economic activity, partly because they lack business. Furthermore, it is not clear as yet if the extent to which microfinance has spread, or can potentially spread, can make a major impression in national poverty reduction.

### **Fragile Microfinance Institutions:**

In addition, many MFIs are commonly either fragile or weak, and often involve large transaction costs. The success of financial intermediation at any time depends significantly on how efficiently the transaction is completed. If the transaction costs, combined with high interest rates, require that the operation in question generate profit margins of the order of 30 to 50 percent, it is not clear that this would be economically beneficial. It is not surprising that in many micro lending operations, trading activity- with quick turnover and large profit margins- dominates. Most of MFIs have not been able to attain viability and sustainability in their operations, lack institutional capacity to expand services in a professional manner and are facing funding problems to enlarge their outreach, and scale up operations and services. They are not able to use the available funds in a cost effective manner.

### **Stand Alone Operations:**

In many cases, microfinance programs have been stand alone operations. There is now considerable consensus that lending to the poor can succeed provided it is accompanied by other services, especially training, information, information and access to land. Credit needs to be supplemented with access to land and appropriate technology. Lack of access to land is the most critical single cause of rural poverty, which dominates the poverty situation in the country. Yet, Nepal does not have a substantial land reform program.

### **Role of Microfinance Institutions:**

Microfinance Institutions vary in quality and strength, and so are their effectively and effectiveness.

) **Lack of Information:**

Lack of regular access to information, the measurement of loan delinquency, setting of interest rates, designing lending procedures and developing business projects, etc. effectively act as the constraints to policy and program formulation and for monitoring and evaluation of such efforts.

Despite ongoing development efforts, poverty remains rampant in Nepal with approximately 31 Percent of the population living below the poverty line. The incidence of poverty is highest in remote and rural areas.

Microfinance has been one of the few effective tools for poverty reduction over the past years. Through the creation of sound microfinance institutions and systems, poor people can safely deposit money and accumulate funds for future investments or emergencies as well as access loans for productive purposes leading to higher incomes. Additionally, microfinance produces an impact in the other areas including good governance, participation in the political processes, women empowerment, social inclusion, and conflict transformation.

Currently, more than 1.6 million individuals in the rural population have access to microfinance services. This figure represents approximately 8 Percent of the population and approximately 26 percent of the people living below the poverty line.

A study conducted by ADB identified three principal roles for the central banks with respect to microfinance such as (1) the central bank should take the lead in matters to do with the regulation and supervision of licensed banks (2) they should take promotional activities to support microfinance, such as pilot project, research data collection and publication, advocacy and training and (3) They should regulate non bank MFIs that accept voluntary savings from members, when the volume of saving exceed a certain threshold. However the nature and depth of the Central Bank's intervention differs from country to country depending upon the nature, pattern, and status of development of microfinance in the country.

However in the context of Nepal the NRB's role has to be viewed as one of creating conducive policy and regulatory environment for the development of microfinance system in the country. This involves the preparation of regulatory and supervisory framework for MFIs, providing them with required infrastructure including performance standards and indicators, accounting and auditing standards and so on. These will serve as a basis to monitor and evaluate their activities.

One of the major areas for the NRB to work upon is to help MFIs to design and implement and interest structure that help the growth of MFIs as viable members in the financial system. Structure of interest has to be reflective of market rate of interest. If it is more, MFIs will be constrained to operate as it will affect not only repayment but also the demand for loans from its clients. If it is less operation will be affected as it is expected to provide all the structure will have to be one which encourages the MFIs for increasing transactions while at the same time help MFIs able to float it by keeping its head above the water level. It has to be constantly on the look out to see any changes taking place and the factors that affect the size of the interest rate.

Nepal Rastra would have to regularly monitor and supervise the operations of MFIs to make these more competent, professional and result oriented microfinance organization. The role of NRB is to ensure that MFIs to operate autonomously in a professional manner.

### **5.3 Recommendations**

Microfinance services are helpful to the poor to enable them to finance specific private income generating activities to increase their income. However, it is vitally important to ensure that the loan facilities provided to the poor are not utilized for consumption purposes. The actions of such borrower, if imitated by other poor people, could produce a negative impact on the future growth of microfinance. If microfinance is to play a strong role in development, certain requirement needs to be fulfilled.

1. It is important to ensure that a more co-ordinate and concerted effort is required if microfinance is to spread and succeed. The establishment of a high level policy Group (PG) consisting of practitioners, financial institutions, the government and Nepal Rastra Bank is desirable to help the process of microfinance development in the country. The PG can lead the process of microfinance development in the country. The PG can lead the process of national and international coordination, bringing together the government, financial institution, donor countries and international agencies. It can work towards ensuring that government, financial organizations and borrowers in general are consulted. Such a `Group` would be major multi party effort to address the problems facing microfinance. The objective of PG is to foster good practices, including performance standards. The PG will provide advice and provide and Support as a national think tank in the field of microfinance.
2. The most crucial requirement is to perceive microfinance as part of comprehensive program of support to the cottage and small scale industries sub sector. This sector employs thousand of poor; it constitutes an active base for strengthening the private sector. This would entail the government formulating plans and programs to support cottage and small industries in general, of which microfinance should be an integral part. There is a delicate balance to be struck between getting the poor eventually into the market economy and commercial lending rates on other hand, and the importance of providing low cost assistance to them at the initial stage of their entrepreneurship.
3. Right targeting is particularly difficult. Most of often, the very poor are very weak and they might not be able to reap benefit from micro lending, and that it is the “better off poor” benefit. While all poor need to be included in the programs, the shortage of funds implies that special effort are required to reach the less well off among the poor. This is important in the fight against poverty.

4. A crucial part of any future effort should be to strengthen existing MFIs. Dynamic leadership, paid management staff and the provision of information on available services to the poor are probably crucial. This is not the case at present. Information on services for the poor is rarely made reality available.

The long term financial sustainability of microfinance operation deserves particular attention. Microfinance operation are not a welfare or charity operation. Probably the single most important element in ensuring long term sustainability of these operations are to include in them the saving needs. Saving habits are quite widespread in rural areas, but the institutional structure does not usually cater to them.

5. It has been widely felt that an evaluation study needs to be carried out to examine the effectiveness of the MFIs programs. Such an evaluation study will help assess the strength and weakness in the implementation of the programs and will provide further guidance to future efforts.
6. It is necessary to have a perspective plan on microfinance the plan well integrated with nation's economic development perspective plan with clear out objectives, targets and policies and strategies. The plan needs to integrate microfinance sector with the overall national efforts for poverty alleviation.
7. The microfinance sub sector has to be expanded quite rapidly in the near future if it is to accommodate demand for the rural masses. It is not the sheer number of microfinance institutions but degree to which these institutions are able to respond them with their services that will determine their relative contribution in the national crusade against poverty.
8. MFIs in Nepal have shown that a financial institution can be sustainable providing basic services to the targeted low income clients such as small

scale business and farmers. However, for the development of regional economy, it will be necessary to respond various needs for financial services from broader clients without neglecting the poor, though it is a challenging task.

9. In order to obtain more effective statistics and diminish poverty, the outreach of sustainable and sound microfinance institutions to the rural and urban poor must be increased.
10. The micro credit banks should continue its geographical expansion with establishment of new branch offices.
11. The portfolio quality should be increased by recovering non-perform loans.
12. The lending role of the microfinance company in the field of micro credit program and poverty alleviation should be maintained and should improve it's to be more effective.
13. Microfinance institution of the country started functioning with objective of contributing to improving socio economic of the poor, the landless, and the asset less through increasing their access to resources for productive undertakings and employment.
14. MFIs in Nepal has started off with good track record and it need to expand its services, deepen and broaden its capacity building efforts to enhance the retailing capacity of its present and future operations by focusing on following things:
15. Establishment of microfinance training centre: Government should establish microfinance training center. For this, centre needs to be equipped with all necessary physical, human and other infrastructures. The center has to conduct various specialized training programs to its present and prospective clientele group, including small entrepreneurs as well as other MFIs and NGOs to enhance their skill.
16. There should be authorized and reliable Database and resource centre: there should be an authorized and appropriate organization to serve as

Data Base and Resource Center on microfinance. Information on demand and supply of micro finance service is extremely limited in the country. Hence, it could be an effective institution to those interested to know about these services. The center will also support researchers, planners, professionals and practitioners in this filed.

17. Wholesale MF institutions should serve as R &D agency: wholesale microfinance institution should also serve as a research and development agency, doing research works on areas of pertinence in the field of microfinance. Small MFIs cannot afford to undertake impact assessments because they are generally expensive and time consuming. Program should include those for strengthening microfinance institutions to build up their institutional capacities to expand and sustain their operations. Their effort would have to be directed towards lowering its transaction cost and minimizing its interest rate without affecting the delivery of services and the microfinance outputs. One of the ways would be to create in house facilities for conducting market research as an ongoing process.
18. Nepal Rastra Bank should regularly monitor and supervise the operations of MFIs: Nepal Rastra Bank should regularly monitor and supervise the operations of MFIs to make these more competent, professional and result oriented microfinance organization. The role of NRB is to ensure that MFIs to operate autonomously in a professional manner.

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Appendix I

**Nepal's Human Development Index 2013**

HDI value	Life expectancy at birth (Years)	Adult literacy rate (Percent ages 15 and above)	Combined gross enrolment ratio (Percent)	GDP per capita (PPP US\$)
1. Norway (0.945)	1. Monaco (89.73)	1. Cuba (99.9)	1. Australia (114.2)	1. Qatar (1, 02,943)
92. Srilanka (0.715)	Srilanka (75%)	148. Angola (70.00)	134. India (61.00)	srilanka (5170)
156. Nigeria (0.459)	133. The Bahamas (65.78)	149. Laos (68.70)	135. Morocco (61.00)	161. Rwanda (1,341)
<b>157. Nepal (0.463)</b>	<b>134. Nepal (69.1)</b>	<b>150. Nepal (68.20)</b>	<b>136. Nepal (60.90)</b>	<b>162. Nepal (1137)</b>
158. Haiti (0.454)	135. Tajikistan (65.33)	151. Cameroon (67.90)	137. Swaziland (60.10)	163. Burma (1,325)
159. Mauritania (0.453)	136. Pakistan (64.49)	152. Congo (66.80)	138. Kenya (59.60)	164. Uganda (1,317)
187. Congo (0.286)	191. Swaziland (31.88)	183. Mali (26.20)	177. Djibouti (25.50)	183. Congo (348)

Source: Human Development Reports- UNDP

## Appendix II

## Selected Indicators of Human Poverty for Nepal

Human Poverty index (HPI)	Probability of not Surviving to age 40 (percentage)	Adult illiteracy rate (percentage 15 and above)	People not Using improved Water sources (percent)	Children underweight for Age (percent aged Under 5)
1. Czech Republic (1.5)	1. Hong Kong, China (SAR) (1.4)	1.Georgia(0.0)	1.Barbados (0)	1.Croatia (1)
97. Haiti (31.5)	88.Uzbekistan (10.7)	128.Yemen (41.1)	71. Venezuela (Bolivarian Republic of)(10)	125. Pakistan (38)
98.Equatorial Guinea (31.9)	89. El Salvador (10.7)	129.Papua New Guinea (42.20)	72.Occupied Palestinian (11)	126. Ethiopia (38)
<b>99.Nepal (32.1)</b>	<b>90.Nepal (11.0)</b>	<b>130. Nepal (43.5)</b>	<b>73.Nepal(11)</b>	<b>127. Nepal (39)</b>
100. Rwanda (32.9)	91. Kazakhstan (11.2)	131.Mauritania (44.2)	74.Kyrgyzstan(11)	128. Burundi (39)
101.Pakistan (33.4)	92. Guatemala (11.2)	132.Morocco (44.4)	75.Syrian Arab Republic(11)	129. Afghanistan (39)
135.	153.Lesotho	151. Mali(73.8)	150.Afghanista	138. Bangladesh

Afghanistan	(47.4)		n(78)	(48)
(59.8)				

Source: Human Development Report-UNDP