

**Challenges and Issues Currently Experienced
by Micro Finance Institutions (FINGOs) in
Nepal**

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Introduction

Poverty reduction is an overarching development goal for Nepal. Providing rural poor with financial services is considered to be one of the key inputs to achieve this goal of poverty reduction. But looking at the diverse topography, lack of access to financial services has been one of the major obstacles to accelerate the socio-economic strata of disadvantaged community people living in remote and inaccessible areas of Nepal.

The difficult topology and the inequality in income (for example the Gini coefficient increased from 34.2 in 1996 to 41 in 2004) has left poor and ultra poor especially living in rural and remote areas lagging behind and feeling excluded from the development mainstream.

Low levels of family incomes have limited the poor families to self finance on farm and off-farm income earning activities. Adequate access to financial services has therefore been considered essential to promote the growth and contribute to reduce the widespread poverty. Over the last four decades there has been several efforts made in the financial sectors in addressing the needs of financial services to support poor and ultra poor for creating self employment opportunities. Accordingly, there has been continued emphasis to expand the financial services to rural and poor through several targeted programmes related to microfinance services.

Microfinance Institutions in Nepal working as Non Government Financial Intermediary Organizations (FINGOs) registered under Society **Registration** Act 2034 and licensed under Financial Intermediary Act 2055. FINGOs are working in 38 districts with coverage of 63% hill districts and 36% Tarai districts

Microfinance service providing organizations mainly target excluded (*dalit, janajati*) and low income level people especially women living with hard economic conditions. These institutions have been playing significant roles to reduce social and economic poverty in rural and urban areas. Microfinance sector in Nepal is seen as a joint effort of Government and private sectors implementing various financial programmes including Grammen replications, savings and credit cooperative activities, number of informal credit groups promoted through different donor supported programmes, such as Poverty Alleviation Programmes and the other activities supported by different donors and INGOs.

After the decade of 1990s, the dawn of economic liberalization is started in Nepal where the institutions involved in community based financial activities were started to give legal recognition and licensed by Nepal Rastra Bank (NRB) so as to create conducive policy support environment to formalize the micro financing services. As a result, there are 45 institutions currently in operation to serve poor community people for the microfinance services. But the number of such institutions has not been increased due to restriction on licensing to additional FINGOs; whereas over the last decade, new commercial, development banks, and financial institutions are emerged as mushroom in the streets of major cities in Nepal receiving license from Nepal Rastra Bank.

The existing microfinance institutions however are serving the poor and destitute in a restricted environment and capacity, covering about 375,000 poor women members, generating more than NRs. 1 billion local saving, utilizing about NRs. 2 billion bank loans, and having NRs. 2.75 billion outstanding credit. These institutions have been facing various challenges to fulfill the objective to reach poor households with service related to microfinance services.

Issues presented here are from the perspective of microfinance services to expand in the rural and inaccessible areas instead of not being confined in only limited areas as it is currently happening. The issues presented in this paper do not mean to undermine the real authority of regulatory and support organizations. However, as we expect that this would help to ease the process for all involved in this sector. Issues related are presented below for developing and expanding micro finance frontiers in Nepal.

- 1 Outreach
- 2 Regulatory Issues
- 3 Unhealthy competition
- 4 Resource Constraints
- 5 Development Challenges
- 6 Management Challenges

1 Outreach

- To include and serve rural and remote households living in hill and Tarai districts is a great challenge to us.
- Combined with providing comprehensive micro finance services (i.e. saving, credit, insurance, transfer and other support) is not sufficient as half fulfilled task.
- Quality and quantity of service in a cost effective manner that sustain service providers and satisfy service receivers has been remained as a tough task.

2 Regulatory Issues

- The FINGOs are registered at District Development Committee, District Administration Office, and are affiliated to social welfare council as patron organization to these institutions. However, the FINFOs have experienced a huge gap between DDC/ DAO and FINGOs in terms of follow up, monitoring and sharing experiences for the growth of FINGOs.
- Numbers of instances are experienced in microfinance sector when comes to the support from government that in the several pertinent issues such as to evaluate these financial institutions, facilitate for integration with development partners so as to create working environment and contribute more towards reducing poverty and empowering women communities. Even lack of supporting programmes

(such as insurances, incentives to work in rural and remote areas, etc.) from Government side hinders the expansion with depth and breadth of microfinance service outreach in inaccessible parts of Nepal.

- The Financial Intermediary Act 2055 was enacted to pave way for creating and developing non government organizations to serve rural and urban poor excluded by formal banks/ finance companies. Pursuing the Act of Nepal Rastra Bank that did take positive step to license some institutions as financial intermediary. After one decade, the environment for institutional growth has been restricted by the Central Bank that enforced to close the door for licensing new prominent NGOs to perform micro financing services and expanding the outreach of microfinance services. FINGOs' practitioners feel that the legal environment is choking and unjustifiable contrary to the liberal environment given to commercial, development banks, and other institutions.
- Moreover, NRB declared policy under pressure of some vested interest group of banking sector for allowing them to open microfinance banks (Class "D" Banks) as subsidiary companies of commercial banks, development banks and finance companies. All the microfinance practitioners working in this field feel that this is an act of diverting microfinance business from local and experienced institutions to commercialized and joint venture sector with the possibility of serving their own interest besides serving the interest of poor and disadvantaged group of community people living in remote and rural areas. There should not be a separate subsidiary microfinance bank for commercial / development banks and finance companies that they have already a comprehensive mandates to serve urban as well as rural poor clientele. It is likely to add oil in water. The licensing authorities seem to be in confusion this situation may lead shift funds of deprived sector lending (DSL) from one account to another and treat it as the service microfinance. Similarly, many commercial and development banks also do not seem comfortable to this provision, and intend to build relation with local institutions. This leads to more dilemmas for the microfinance players who are working in this field.
- Nepal Rastra Bank has restricted FINGOs to add new working areas for expansion of outreach. Recently NRB has issued notice to give approval to add one district, which incorporates cumbersome criteria. NRB however seems very liberal to open branches of commercial banks at any place.
- Nepal Rastra Bank as a regulator has not recognized FINGOs and its association to make any contact and communications like other banks' associations. It seems less importance has been given by NRB to non government sector.
- Nepal Rastra Bank has inspected 3 FINGOs during 2065/66. This shows the lack of regular supervision in this sector and hinders the appropriate linkages and support to the institutions.

3 Unhealthy Competition

- Healthy competition is necessary for smooth and sound development of micro finance services. It is also felt that because of lack of supporting environment and less of coordination between government agencies and micro finance banks/institutions, number of instances where duplications in the working area and of clients have been noticed. In limited areas where more institutions work with the same clients. Efforts still seem to be made from government/ NRB side as well as close coordination between the players of this sector to avoid such unhealthy competition.
- Rural Micro Finance Development Center (RMDC) also provides with credit funds through these financial institutions that serve the same clients, whereas clients who have dire need of microfinance support in the rural areas are still not in the reach of these micro finance banks and institutions.

4 Resource Constraints

- FINGOs working in hill, rural and Tarai areas face shortage of credit funds. It is estimated that 45 FINGOs have used .005 per cent of total loans disbursed by commercial banks during 2008.
- Nepal Rastra Bank's Rural Self Reliance Fund (RSRF) aims to promote local NGOs cooperatives and institutions, which is still far below from its performance. Four FINGOs have received credit funds from RSRF out of total 334 recipient institutions by mid-July 2008. Average size of outstanding credit fund to all 334 institutions stood at NRs. 272,455, which shows that this is much less to meet the expenditure of the recipient institutions.
- Out of three per cent of deprived sector credit funds which comes to around NRs. 12 billion, NRs. 4 billion was allocated to youth employment program has led to make the another limitation to working for MFIs. It is felt that youth employment scheme is an essential, but it needs fund from different windows rather than the same RSRF with the main concern of not making any distortion in the microfinance sector. One of the concerns is observed that commercial/ development banks seem investing in import-based consumer goods. This should be regulated by government/NRB authority. Such practice never allows rural economy to receive fund for mobilizing local resources and create more self-employment opportunities at local levels.
- Due to changes in cost of raw materials and labor, need of micro credit in this sector is insufficient. At present institutions are getting funds of short term nature from banks. To finance medium term enterprises like- low cost housing, alternative energy equipments, and cottage industries, credit fund of larger loan for scale up and comparatively higher investment is necessary.

- It is felt that micro credit defined by banks and neighboring countries should be included as credit ceilings for the institutions.
- Similarly, the graduated clients who have attained proficiency in managing enterprises of higher scale credit amount should be increased. To meet all these needs, it is strongly felt that there is a need to increase 3 per cent of deprived sector fund to 5%, which will make the commercial and development banks responsible to the rural and poor societies.

5 Development Needs

- It is paradoxical that institutions having a decade long experience in rural microfinance are restricted to open banks. It is felt that this must be revised.
- The government should define its role to support micro finance sector, attention seems required with serious attention.
- More than a year ago, a draft provision for National Micro Finance Fund was prepared but it is still to come to enforce. This shows government authorities/ NRB's less attention to expedite such important issues, which need to come into practice for the growth and development of this sector. Being as network organization, MIFAN can play a vital role if handed over the responsibilities for the supervisory and overall facilitation for finalizing this.
- Information center for the institutions should be developed.
- Human resource development in micro finance is a critical need for which government, Nepal Rastra bank and Institutions must work jointly.
- The risk fund and insurance funds are necessary to cover natural and physical hazards faced by clients and financial institutions.
- Micro credit insurance is a burning issue and a need to be managed by institutions, the government, support organizations and insurers. Due to lack of credit insurance, clients and institutions face loss of property and loan amounts causing loss of asset and income to the poor households.
- Some funds for developing infrastructure (software, training to staff) of the institutions that serve in rural and hill areas are necessary.
- NRB disseminates circulars and other information to NGOs that are not easily available to the concerned institutions. MIFAN can play an effective role in disseminating such crucial information through its network with members if handed over such assignment by the government authorities.

6. Management challenges

There are some critical challenges that FINGOs are facing to the areas as highlighted hereunder:

- Resource and fund management at local branch unit is risky (because of the lack insurance and security measures);
- Efficient and trained staff is deficient.
- Lack of committed staff/ personnel to work in rural and remote areas;
- Lack of institutions doing monitoring and supervision of financial institutions and guide them for appropriate linkages and supports.
- Lack of support for the second tier organization Like MIFAN, which can play a greater role for monitoring and supervision of the financial institutions;
- Trade unions are being formed in institutions demanding equal facilities at par with government and banks. To cope up with such issues, financial institutions and regulatory bodies should work together.

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