# Govt's short-sighted loan exemption burdening rural MFIs in Nepal

After long awaited end to "Nepalese People's War" came in 2005 through a permanent peace accord and the forming of a pro-democratic alliance between the then [1]Communist Party of Nepal (Maoist) and several other mainstream political parties (in opposition to the then King Gyanendra), with an unprecedented democratic republic setup, Nepal entered a new era. The dust of the decade-long civil war may have settled; however, the ruins of the blown up infrastructure, the shambles it has caused in all levels, and the disconnect it created in service delivery in rural areas stands vivid as a reminder and the legacy of its own.

In building the nation, now, the disparity between urban developments that did not came to a halt even during the decade long of insurgency and the rural which virtually stopped is being addressed. During the ten years, what little government services that were being provided was through office of village development committees (VDCs)—Nepal government's smallest administrative area. Now that somewhat conducive environment exists, to add government services and to extend non-government services top down, from center to regional and then to rural areas, the importance of mediating agencies cannot be undermined: if VDC offices are such agencies for government, MFIs are for any non-govt. services. In other words, in Nepal, MFIs' roles extend beyond the boundary of financial access as they are seen as comparatively matured institutes and have bigger membership base for bridging the service gaps by extending and delivering needed service in rural areas.

Out of four major categories of licensed financial institutions in [2]Nepal, although MFIs in particular have been catering services to the rural poor, only 20% of those who live under poverty line have access to microfinance. In a country in which about one third of the population live under poverty, agro-climatic landscape also has played its hindering role in impeding MFIs' outreach beyond urban areas. Out of total 75 districts, 20 of the mountainous ones do not have finance institutions whatsoever as compared to hilly districts having few; where as the districts in flat lands, also termed as *Terai*, have the most. In totality, the service is limited to only 6.3% of the total 28.5 million populations.

As any general MFIs, micro loan is the primary service. However, the MFIs also have been providing other services that include live-stock insurances, access to market information and markets, facilitating fertilizers and pesticides market and so on. The services are diverse; and so are the MFIs. There are: 1) Grameen model MFIs; 2) Small Farmers Co-operatives Ltd. (SFCLs); 3) Saving and Credit Co-operatives (SACCOs); and 4) Financial intermediary NGOs (FINGOs). Through 15 microfinance banks, as s many as 547,435 people have been served through Grameen model MFIs. 250 SFCLs have served 1,45,419 rural famers; 5161 SACCOs have served 7,14,516; and 45 FINGOs have 3,81,392. (Photo left: a collection center for produce run by SFCLs)

In contrast to other MFIs, SFCLs stand out unique because of its history, institutional maturity, networked setup and its outreach. As the country's first poverty reduction program, Small Farmers Development Program (SFDP) was implemented and tested in 1975 by Agricultural Development Bank,

[1] Now the party name is Unified Communist Party of Nepal (Maoist)

[2] A) Commercial banks; B) Development Banks; C) Finance Companies; D) MFIs

Nepal (ADBN). Although it was first of its kind to provide micro credit on non-collateral and group guarantee basis, the pilot proved successful from the stand point of ameliorating the socio-economic condition of the marginal and small farmers. Starting in 1993, the bank with a view to contribution on the uplifting of the rural poor people through their own institution in the VDC level started institutional development of the program with the support of German Technical Cooperation (GTZ). Institutional Development of SFDP now is seen as an innovative, cost effective and ownership model of rural development as the rural poor farmers themselves own and manage their SFCLs. By the end of 2003, more than 155 SFCLs had been formed. In view of the likely increase in the number of SFCLs in future and the realization that they need constant financial and technical support of the apex level institution for their sustainability and growth, in 2001, [3]Sana Kishan Bikash Bank (SKBB), a micro finance bank, was established in order to extend all kinds of support largely to the SFCLs and the similar other grassroots level MFIs. Today, with linear increment of about 12% each year, there are 250 MFIs within the SFCL Network (see Figure 1 on the institutional framework on how SFCLs operate).

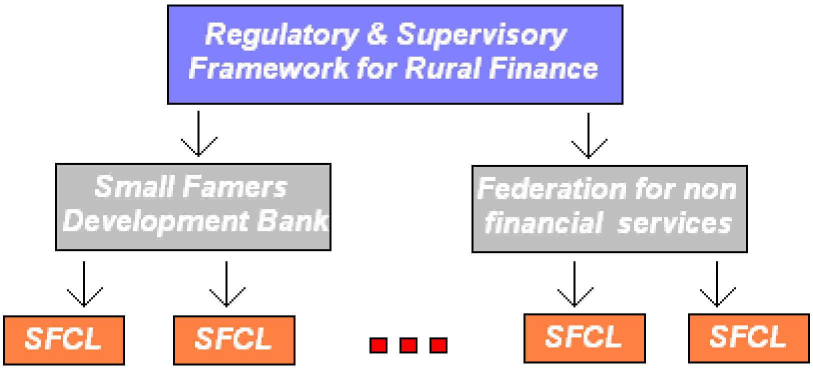


Figure -1: How SFCLs operate
(In addition to central level federation, there are district and region wise federations as well)

During the civil conflict, roughly 20% of these MFIs were either vandalized and their document destroyed or the office building burnt down. The rationale behind this uprooting act was the notion that SFCLs were charging interests to poor farmers; and in return, the loan was deepening the poverty in rural farmers instead of alleviating it. In contrast with other MFIs' APR of up to 35%, SFCLs charge, in a diminishing standard, as low as 13% and as high as 24% based on loan types and purposes. As these MFIs are also known us development cooperatives, their bylaws commits them to contribute to village development activities. And willingly, the contribution is either through financial terms or other. For example, SFCL at Kumros VDC, Chitwan District, contributes 20% of net profit to neighboring public school every year. In Chayanpur VDC, Dhading District, the cooperative members literally dug and paved 7 Kilometers motorable road in order to ensure access to transportation. Such endeavor is uncommon with any other MFIs in Nepal because the ownership of this intensity is unmatched by any other. These SFCLs are located in much deeper segment of rural areas than any other MFIs. Therefore, their services to local famer members are highly valuable and important. (Photo above: Author interacting with SFCL members in Argakhanchi district)

[3] Literally means, Small Farmers Development Bank

Despite the experience during the insurgency, these beaten-down SFCLs survived and have bounced back. Out of 20% affected SFCLs, not a single shut down. Instead of recognizing these MFIs as champions and promoting their replication and scaling, unfortunately, what the then new government in 2005 put forward in the budget announcement instead forced them to loose members because of unavailability of timely wholesale loans, ambiguous definition of beneficiaries and discrimination against the borrowers who received loans through SFCLs' 'Internal source'.

In 2008, UCPN-M led government's national budget announcement in regard to loan exemption following schemes was stated:

"For small farmers and small cottage entrepreneurs who are affected by natural disaster and conflict and those who live under poverty line, if the loan borrowed from SKBB, Nepal Bank Ltd. and Rastriya Banijya Bank is up to 30,000 NPRs ([4]417 USD) the total loan and the interest thereof is exempted; and if the loan is more than 30,000 NPRs and up to 100,000 NPRs (1,389 USD), only interest and late-payment fine is exempted. The total estimate of such exemption amounts to 9,18,00,00,000 NPRs (127.5 Million USD) and the Nepal Government shall pay the listed banks within the span of ten years."

Further, the announcement also stated 21 and 18 months' timeline, respectively, for the concerned banks to complete the exemptions as directed. Although it was a good gesture from the government's side, the move was short-sighted and its impact was undermined because of following reasons:

1. Out of the three banks, SKBB was affected most as it could not provide wholesale loans to SFCLs due to unexpected and sudden depletion of liquidity to cover the exemption. The unavailability of loan trickled down to borrowers and some of the disgruntled members gave up their memberships and went to other financing sources. (Photo right: SFCL manager introducing new saving scheme)

2. The announcement did not have any guidelines for identifying the potential beneficiaries. The ambiguity escalated members' attempts to qualify for the schemes so that their loans would be exempted. The services were temporarily halted as SFCLs had to mobilize already limited resources to execute the government directive.

3. 80% of the SFCLs mobilize their 'Internal fund' as loans of different kinds to members. Those who borrowed from the 'Internal fund' did not qualify for the exemption scheme. The discrimination was unfair to the farmers but SFCLs could not simply write-off such cases. As a result, some members threatened not to pay back the loans. The deterioration of trust between the farmers and SFCLs was inevitable.

Since the announcement, SKBB has not been able to provide any loans to SFCLs to this date because the timing also coincided with Nepal's ongoing liquidity crunch since last year. Amidst the prevailing situation, in December 2009, SFCLs managed to exempt their selected borrowers (See Table-1). Out of 33,853 borrowers (up to 30,000 NPRs) that were exempted, 75% withdrew their membership because they no longer want to be burdened with the loan, at lest for the time being. For the second type of

[4] With exchange rate of 1 USD = 72 NPRs

exempted loans only 10% decided to leave SFCL. The 90% had other smaller loans with the SFCLs, thus they have continued their memberships.

| Schemes | SFCLs | Borrowers | Exempted Loan | Exempted Interest | Total Exemption |
|---|---|---|---|---|---|
| Up to 30,000 NPRs | 214 | 33853 | 578,387.00 | 297,312.00 | 875,699.00 |
| Between 30,000 NPRs and 100,000 NPRs | 109 | 1452 | 0.00 | 58,871.00 | 58,871.00 |
| | Total = | 35305 | 578,387.00 | 356,183.00 | 934,570.00 |

Table1: Total exempted SFCLs and Borrowers
(In USD, total exemption is about 13,000)

Had not central federation of SFCLs lobbied the Nepal government to release the proposed exemption budget all at once instead of waiting for 10 years, these MFIs would have lost more members. With the budget made available, SFCLs recovered the paid-out credits right away. However, borrowers of loans from 'Internal fund' are still unhappy with the rationale provided to them by SFCLs; some members still claim that they should have been qualified for the schemes; and the willing borrowers are not provided with additional loans because SKBB does not have any wholesale loans available at the moment. And SFCLs' 'Internal funds' are not up for grab because members feel that history will repeat again.

It is indeed disheartening to watch how the government's short-sighted loan exemption has burdened rural MFIs in Nepal. Although it is a good gesture to help rural farmers escape poverty, lack of labyrinth homework to develop framework and strategies and long-term consequence assessment cornered these MFIs only to devolve. If government is to leverage their potential roles as mediating institutions for service extension and delivery in rural areas, it should learn from this experience and should work towards developing a conducive environment in which all MFIs would evolve and flourish.

## About the Author

Mr. Tikajit Rai is an electrical/communication engineer by trade and a social entrepreneur by profession. Now he runs Nepal's first social enterprise, Magnus Consulting Group Pvt. Ltd. In 2005, he piloted a new model which yielded successful result and he penned the model: Private Community Partnership (PCP). The enterprise has adopted this into its strategies in which it partners with rural MFIs to build ICT capacity to operate his company's software: SimFin. Then other eServices—Internet, VoIP, email, money transfer, mobile phone recharge and international market linkage—are integrated. In the PCP model, both partners invest in service development. Till date, there are 105 partners and growing each year. He co-founded Nepal's first e-commerce venture company in 1998 (now Thamel.com) while living in the USA. He returned to native country after 12 years in 2003 to work with the MFIs to extend services to marginalized communities in rural part of Nepal. His company is also a certified Mifos Specialist by Grameen Foundation (www.grameenfoundation.org). As an enthusiast and advocate of project management, he also chairs Project Management Association Nepal. He can be contacted at tika@magnus.com.np.