# Problems of Micro Finance Program in Nepal with References of Cooperative Limited

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**ABSTRACT**

*Microfinance is one of the self-help programs run in Nepal both bank and cooperative limited. After COVID-19 pandemic microfinance program run by cooperative organizations face the problem like loan deficit, misusing the loan, failure to balance the bad debt, face problems to maintain the financial discipline. In this context, this study analyzes the causes of the failure of cooperative in Nepal. Main objective of this study is to highlights the perceptions of stakeholder toward the ongoing problems of microfinance in the context of Nepal. Research question of this study focuses on why microfinance programs run by the cooperatives have been facing the problems in Nepal and what are the possible solutions of the problems that are facing by the cooperatives in the mobilization of microfinance. The study followed the qualitative survey research design and analyzed the perception of stakeholders and possible way of solving problems on the view of the participants. Five individuals were involved in this study and expressed their opinion on the basis of the issues. Conclusion of this study has been made on the basis of primary data that has collected from the field by using in-depth interview. Misusing the resources, neglect the principle of cooperatives, weak monitoring, political protection on financial crime are the major cases of creating problems on micro credit run by the cooperatives in Nepal.*

**Keywords:** Cooperative, Financial Discipline, Micro Credit, Microfinance, Nepal.

## Introduction

In recent time micro finance programs run by cooperatives limited have been facing various problem like problems of refund of the saving of the depositors and members. Nepal Rastra Bank (NRB) reports (2023) notes that microfinance have not face single problems so that it is urgent need to correct the microfinance" (Prefix. i). The report has prepared by given the title "Report related to solve the problem of microfinance 2080 BS" shows various problems related to microfinance. I this context, the study analyzes the perception of stakeholders about the problems of microfinance. Main objective of this study is to highlight the causes and consequences that perceive by the participant about the problems of microfinance run by cooperatives. In the context of Nepal microfinance programs run by financial institutions have taken as main tool of poverty alleviation and empowerment of women and marginalized community but now microfinance cannot fulfil the objectives of microfinance run by cooperatives create problems in nation. Financial anarchy of cooperatives brings serious problem among poor and marginalized people because saving of the poor has collapse with the bankruptcy of the cooperative.

Microfinance program is run by banking and cooperative institutions to provide loan in small scale. Guinnane, (2011) notes the concept of microfinance by comparing the modern microfinance and argues, "The term Micro finance draws parallels, such as those between modern microfinance institutions (MFIs) and the innovative German credit cooperatives from the latter part of the 19th century"(Guinnane,2011). In the same line, Lapenu & Zeller, (2001) highlights, "Microfinance is a system that aims to provide small loans to impoverished individuals, enabling them to generate income and establish their own small businesses" (p.34). The concept of micro finance developed during the time of 1990 to address the problems of poor people living in rural area. Roy (2003) notes, "This approach is driven by the recognition that the poor often lack access to traditional financial institutions like banks due to their inability to offer collateral, and the complex loan requirements that are difficult for the uneducated poor to comprehend" (p.44).

Concept of microfinance is effective tools to reduce poverty in south Asia and various donor and investors also joint invest in microfinance. Murphy (2006) notes, "Microfinance should be financially sustainable in order to effectively reach a significant number of impoverished households" (p.32). Microfinance programs run by cooperative appeared in the developing and underdeveloped nation as the main tools of poverty alleviation.  The program is more effective than the system of traditional banking. Lazar, (2008) highlights, "By doing so, they can effectively reduce poverty levels and foster the growth of entrepreneurship, as well as contribute to the social and economic development of underprivileged communities" (p.34). Microfinance provides support to individual who have low-income, including consumers and self-employed workers do not have access to traditional banking services. The goal of microfinance is to create environment for doing business and enhancing the traditional economic related activities. Supporters of microfinance believe that this access can be instrumental in helping impoverished individuals escape poverty. Sanyal, (2009) argues, "Microfinance institutions serve as an alternative credit source with lower interest rates for rural individuals without collateral, unlike moneylenders who demand high interest rates. These institutions support to enhance the small-scale businesses in rural and agricultural sectors" (p.529). Microfinance principle focuses on economic viability of rural people who have low income and cannot have access of traditional banking system. Premchander, (2009) notes, "In addition to disbursing loans, Microfinance Institutions (MFIs) also provide a diverse range of financial services, including savings and insurance options" (p. 2). Moreover, banks find it costly and time-consuming to cater to small-scale clients (World Bank, 2009, p. 54).

Consequently, MFIs began extending loans to the impoverished population, as banks were unwilling to do so (World Bank, 2009). Additionally, many microfinance programs adopt a group-based approach, where loans are exclusively granted to members; thereby preserving the integrity of the group (World Bank, 2009, p. 19). Microfinance has long been recognized as a crucial tool for development. The Grameen Bank, led by Muhammad Yunus, received the Nobel Peace Prize in 2006 for its efforts in promoting economic and social progress. South Asia, particularly Nepal, has embraced microfinance as an integral part of its development strategy. While talking the history of microfinance sector in world it can be reached the date 1950s to 1960s when it was primarily served by cooperatives and normal banks. However, in 1980, several pilot projects and initiatives were implemented to introduce financial and banking services to assist the poor and women.

Although only a few groups of poor people benefited initially, these services were ultimately deemed ineffective. It was not until the country's Sixth Plan (1980/81-1984/85) that it was officially recognized as a tool for poverty alleviation. Following the restoration of democracy in 1991, the microfinance sector gained momentum during the 1990s and early 2000s. The government took further steps to strengthen Microfinance Institutions and provide financial services to the poor and women. This included the establishment of five Regional Development Banks (RDBs) in each Development region, based on the Grameen model. The sole objective of these RDBs was to provide micro-credit services to the poor and women. Eventually, these Regional Development Banks underwent transformation. Following the privatization process, Microfinance Development Banks (MFDBs) were licensed as class 'D' financial institutions. In the early 2000s, several private microfinance institutions and NGOs emerged, offering microfinance programs. NGOs like Nirdhan Utthan Bank and Center for Self-help Development (CDF) successfully implemented microfinance programs under the Grameen Model, eventually transitioning into Microfinance Development Banks.

Additionally, other MFDBs such as Chhimek Bikas Bank Ltd. (CBB), Deprosc Bikas Bank (DBB), and Nerude Microfinance Development Bank Ltd. (NMDB) were established. NGOs engaged in community-based financial activities were also granted legal recognition and licenses by Nepal Rastra Bank (NRB) to formalize microfinance services, leading to the formation of Financial Intermediary NGOs (FINGOs). As a result, Nepal now boasts a diverse range of active microfinance institutions catering to the financial needs of the underprivileged. Government officials, industry experts, and academics all agree that microfinance plays a key role in poverty reduction and women's empowerment. The country's latest Monetary Policy (2022/23) and budget (2022/23) both emphasize the importance of microfinance, with a significant fund allocated to provide credit to farmers, however, the reality has been worse and micro finance organized by the cooperatives have been facing problems since the tie of COVID-19 pandemic. During the time of COVID-19 pandemic agriculture sector could not found market because of the long lockdown and band of the market. Demand of loan of Agriculture and production sector dramatically reduced and microfinance sector specially, cooperatives knowingly are unknowingly shifting the investment sector from a agriculture and small business to real estate sector.

Despite the challenges posed by the Covid-19 pandemic, microfinance institutions in Nepal are experiencing growth in terms of branches, customers, credit lent, and profits. Through interviews with key stakeholders, it is identified three central problems in the sector. Firstly, microfinance has deviated from its original social objective. Secondly, the government has not effectively regulated the sector. Lastly, there is a lack of quality data and information for policymakers and other stakeholders to make informed decisions. To address these challenges, government directly engages with the groups protesting against microfinance practices, rather than delegating this responsibility to a voluntary association with limited power. Secondly, policies aimed at expanding microfinance services to hard-to-reach areas should be accompanied by investments that strengthen local economies.

## Research Methodology

The study follows the qualitative survey research design. As stated by Nunan (1992, p.140), "the primary objective of a survey is to capture a snapshot of conditions, attitudes, and events at a specific point in time." Surveys are a crucial research method in educational investigations, primarily conducted to understand people's attitudes, opinions, and specific behaviors related to certain issues, phenomena, events, and/or situations. Survey is the best research design carried out to find out public operation, and the behaviors and attitudes of different professionals to access certain activities and study certain trends almost at single point of time. No other research strategy matches the strengths of survey research in its potential for handling external validity (Kidder, 1991, p.81).

Qualitative research design helps to analyze the perception and opinions of the people on certain issue. Crisis of microfinance is one of the major issues of Nepal that has been main subject of discussion in public. In this context it has analyzed the perceptions and opinion of five individuals who are directly involve in both cooperative and micro finance sectors. These five individuals were selected from five different sectors. Purposive sampling was used to select these five participants because their perceptions reflect fact that happened in the cooperatives of Nepal. Among these five participants, one from management team (director of cooperative or micro finance, one from client or depositor, one from policy maker, one from the member monitoring mechanism one from the export. Five subjective questions were asked to the participants covering about current scenario to the possible situation of the problems of microfinance in Nepal. All the participants were selected from Kathmandu valley.

## Literature Reviews

Microfinance was initially hailed as a means to unlock the potential of impoverished individuals who relied on self-employment. The concept was simple: by offering capital, microfinance would revolutionize the businesses of its customers, leading to higher earnings and, ultimately, the eradication of poverty. This approach resonated with prominent economic theory, which connected credit market inefficiencies to productivity issues and attributed them to information imbalances within conventional lending agreements. Yunus (2008) notes, “Finance was seen as a tool of personal transformation, and it captured the imaginations of those seeking new modes of social and economic change” (p.4). Yunus presents micro finance as means of economic transformation. Yunus (2016) further claims, “Microfinance would transform customers’ businesses by providing capital; that would increase borrowers’ earnings and ultimately eliminate poverty” (p.4). Microfinance has been praised for its introduction of innovative credit contracts, such as group lending and installment-lending. In the same way, (Conning & Morduch 2011) highlights, “Microfinance demonstrates a new mode of development intervention, one that displaces governments as central actors and turns to market-mechanisms to deliver services through a range of institutions that integrate social and financial goals" (p.408). The implementation of the new Microfinance Policy, approved by the Government of Nepal in June 2008, lead to alterations in regulatory oversight. A key recommendation of the policy is the creation of a Second Tier Institution that is responsible for monitoring, regulating, and facilitating microfinance operations. As a result, the existing regulatory framework will undergo changes that are currently unforeseeable. Nepal has an experience of more than five decades in microfinance starting by SFCL in 1975. (Dhakal, (2012) notes, "Nepal has developed considerable history in providing microfinance services which is evidenced by emergence and growth of a large number of micro-Finance institutions (MFIs) and microfinance programs over time" (p.2).

There exists a significant challenge for microfinance institutions due to their limited transaction volume. The market has adapted to meet the changing demands, with traditional banks having deep-rooted connections. Consumers can acquire goods at a lower cost from mainstream banks compared to MFIs. The majority of established banks offer loans at a low interest rate, typically between 8 to 12 percent, while microfinance institutions charge higher interest rates ranging from 12 to 30 percent of the principal amount. The literature review is essential within this framework, aiming to position the proposed study within the existing knowledge of the field. By establishing a theoretical foundation, it helps to refine the research focus. Karn (2018) sheds light on the challenges and opportunities in the microfinance sector in Nepal. His research identifies areas in microfinance that require improvement, particularly in targeting strategies. The study also highlights gaps in social awareness within the Nepalese microfinance sector. Furthermore, Karn suggests various opportunities in microfinance, including promoting economic growth, enhancing accessibility, and expanding outreach. Njeru & B.W. (2012) conducted an analysis of internal and external factors contributing to loan delinquency issues in Kenya. Both types of factors significantly impact loan delinquency performance. Their findings demonstrate a positive and significant correlation between loan delinquency and the performance of microfinance institutions. The study concludes that internal and external environmental factors play a crucial role in influencing the loan delinquency performance of microfinance institutions (MFIs) in Kenya. Njeru & B.W. further recommend that MFIs focus on managing their portfolios by addressing internal factors that are within their control to effectively tackle delinquency issues. Ahamad (2015) emphasizes that the quality of a loan portfolio is directly linked to the credit management process, specifically through the effective appraisal of borrowers. The study illustrates the connection between credit risk management and the successful performance of loans. Kayastha, (2013) provides an in-depth analysis of the microfinance landscape in Nepal, outlining the development process, operational modalities of microfinance institutions (MFIs), and various regulatory frameworks. Furthermore, the paper delves into the current challenges facing microfinance in Nepal and asserts that.

**Problems of Micro Finance Program in Nepal run by Cooperatives**

In the context of Nepal, cooperatives have faced various problems and negative attitude toward microfinance program run by the cooperative have been increasing. In this context, I have asked the questions to the stakeholders like manager of the cooperative and micro finance, client, directors of the monitoring office of the cooperative department and Nepal Rastra Bank, expert and policy makers.

**About Participants**

P1 is male. Work as manager of the cooperative and he has been handling the cooperative for 10 years. He is 50 years old and passed master degree in finance.

P2 is female. She is 45 years old. She has taken loan from cooperative. She also deposits from the cooperative. She has lost around 2 million from the cooperative. She has involved in the microfinance activities for 10 years.

P3 is male. He is 52 years old. He has been working in cooperative department for five years as evaluation head.

P4 is female. She is 40years old and elected as Member of Parliament. She directly involves in policy making activities

P5 is male. He is expert and researcher of microfinance and cooperative. He has been studying in the field microfinance for 12 years.

**Current Situation of Microfinance**

In the process of interview, it has been asked question related to the current situation of the microfinance program run by cooperative, problems of the microfinance, cause of the problems faced by micro finance program. While asking the question about the current situation of microfinance run by cooperative p1 notes "microfinance run by bank and cooperatives have run on the guideline of Nepal Rastra bank so that policy of Nepal Rastra Bank irresponsible to-bring present situation. Nepal Rastra Bank could not effectively monitor the micro finance program so that micro finance program and cooperatives used resources in their personal benefit rather than the benefit of organization and community". (Personal Interview, 2080). In the same line p2 notes:

> Monitoring and evaluation policy is confusing. There is weak monitoring policy that creates problem in cooperative sector. The current situation of the cooperative and microfinance is not so effective to maintain its' objective because people have negative attitudes toward cooperative and micro finance. In initial phase cooperatives were sound in their financial activities because the amount of money is not so huge but in latter phase cooperatives are develop as means to money laundering. Billions of illegal money endorsed in cooperative sector and the amount of money utilize in nonproductive sectors like real estate. At that time cooperatives were succeeded to collect large among to saving from local and utilized the collected saving for personal benefit. (Personal Interview, 2080).

**Problems and the Way of Solution of the Problems**

P1 and P2 have different opinions about the current situation of the cooperative. In this context p3 highlights on that overall situation of the cooperative is not so bad because only 5% cooperatives are in black list. Cooperatives of rural area play positive role to provide service to the poor and marginalized community. These cooperatives have sound record on resource mobilization and service delivery. The cooperatives of urban and semi urban areas involve in illegal activities due to the political power. He adds, "Cooperative department is always conscious on the controlling cooperatives and microfinance but political barrier and over influences of political party create problems in the process. Due to the reason these cooperatives have been facing the problems since long time" (Personal Interview, 2080). P3 highlights the political influences as major problem to regulate the cooperatives and micro finance. In the same line p4notes,"political party leaders are involved in the cooperatives and they hold the legal procedure that creates problem in cooperative and micro fiancé sector. In microfinance and cooperative sector government provides certain support and discount on tax that provision is highly misuse by the cooperative. There needs to reform on microfinance sector because various ill practices have entered in cooperatives and microfinance sectors"(Personal Interview, 2080). P4 is not ensured that all the cooperatives and microfinance sectors are not wrong, however, he thinks that there is needed to reform in both policy and practice as well as evaluation system. In this context p5 noted that there need to minute research on the situation and position of cooperatives and micro finance run by various financial institutions. There is no single cause to bring problems in cooperatives and microfinance. Various factors are responsible for the ongoing problems such as weak policy implementation, misuse of public deposit, weak monitoring, political influences in cooperatives and micro finance program. Except that ethical issue plays important role on maintaining economic discipline. Managers and board members of the financial institutions knowingly misuse the deposit. Some of the board members direly involved in misusing the deposit. They use the public deposit for personal benefit and betrayal the shareholders and depositors. P5 further highlights," It is necessary to investigate fairly and should punish the person who are directly or indirectly involve incorruption on microfinance" (Personal Interview, 2080). All the participants are agreed on the worse situation of microfinance in Nepal; however, there is no single and ultimate way to solve the problems because problems have not created by single cause. NRB report (2023) highlights the certain aspects and notes, poor monitoring system, multiple and multi lyre financing, duplication on program, seasonal migration, rapid urbanization, downfall of real estate sector, long run impact so COVID19 pandemic plays important role on creating challenges in microfinance as well as cooperative sector". Globally microfinance plays positive role to reduce poverty and increase the entrepreneurship in rural area, however, in the context of Nepal various challenges have been seen since long time because microfinance program has deviated from its' principle.

## Conclusions

Microfinance run by cooperative s have been played positive role in rural area but in urban and semi urban the overall situation is not so well. There is no single cause of the problems occurred in cooperatives, however, misusing cooperative's principle and political protection of management team are the major problems of cooperatives in Nepal. Long run impact of COVID-19 and downfall of real estate business is known as the cause of problems occurred cooperative sectors, however, investing in real estate is not the principle of cooperative and microfinance. Weak management, confusing policy, weak monitoring, lack of transparent, lack of awareness also play role on creating problems in microfinance run by cooperative. Lack of coordination between and cooperative department also brings problems to handle the cooperative. In Nepal cooperatives have run the basis of fake data and collect the large amount of deport from public that later create problem in management. Lack of proper legal environment and managerial skill microfinance and cooperative use fund like commercial bank that creates problems on its sustainability. Management team of the cooperative use deposit for personal benefit and harm of institutions that develop the risk on the cooperative.

## Recommendations

Support formal-informal sector linkages: The proposed Microfinance Act should incorporate provisions that facilitate the connection between the formal and informal financial sectors. Unfortunately, the new Microfinance Policy fails to address these crucial linkages. Enhance standards. It is imperative for regulatory bodies in Nepal to strengthen their standards requirements for microfinance providers. By doing so, they can effectively assist the Central Bank and regulatory authorities in managing key aspects of the microfinance industry. Furthermore, this would encourage more microfinance providers in Nepal to adopt computerization and recognize the benefits of a high-quality, standardized platform, as described in this report. The expectation is that with increased oversight and transparency, these institutions would be able to deliver excellent services to their clients.

Enable branch less banking: If branch less banking is to be implemented in Nepal, it is essential to develop risk-based Anti-Money Laundering (AML) and Counter-Financing of Terrorism (CFT) rules specifically tailored for customers who handle small amounts of money.

Additionally, the principle of proportionality should be applied to any branchless or correspondent banking models introduced through the centralized ICT platform, with a focus on benefiting microfinance customers.

Strengthen data security and privacy: Regulators are likely to have significant concerns regarding data security and privacy when it comes to a central technology platform. Regardless of the chosen technology solution in Nepal, it is crucial for vendors to ensure that there is no unauthorized access or leakage of data between financial organizations. Robust data encryption and other security measures should be implemented to safeguard institutional data. Moreover, contractual agreements between participating vendors and financial institutions should clearly outline data privacy procedures. In the long run, it is advisable to expand cyber laws to include additional provisions.

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