International Research Journal of Parroha Multiple Campus (IRJPMC)
Volume 02, Issue 02, 2023. PP. 37-48
https://doi.org/10.61916/prmn.2023.v02i01.004
Research Article

Evolution of Microfinance and Its Relevance in Nepal

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Article History
Received: 03 August 2023
Accepted: 15 October 2023

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Cite
Gautam, J. (2023). Evolution of Microfinance and Its Relevance in Nepal. *International Research Journal of Parroha Multiple Campus (IRJPMC)* *2*(1), 37-48. https://doi.org/ 10.5281/ zenodo.10251040

ABSTRACT

This research paper seeks to explore the evolution of microfinance in Nepal and its potential contributions to the nation's inclusive growth. This study employs a comprehensive and interdisciplinary approach, incorporating data from various sources, including government reports, academic research, and field observations. The research uncovers the historical development of microfinance in Nepal, tracing its roots from early government initiatives to the emergence of non-governmental organizations and international models. The paper also presents case studies showcasing the impact of microfinance on poverty reduction, women's empowerment, and financial inclusion in rural and urban areas. Challenges such as interest rates, regulatory frameworks, and accessibility are discussed in detail. Furthermore, the study explores the future prospects of microfinance in Nepal, emphasizing the role of technological innovations and financial product diversification.This research paper provides a comprehensive analysis of the relevance of microfinance in Nepal, shedding light on its historical evolution, impact on poverty reduction, challenges, and future prospects. It highlights the critical role microfinance plays in providing financial services to marginalized populations in a diverse and geographically challenging nation. The paper concludes by underlining the continued importance of microfinance in Nepal's socio-economic development and the need for innovative solutions to address the challenges it faces.

Keywords: *Microfinance, Poverty alleviation, Economic development, Financial inclusion, evolution*

Introduction

Nepal, a landlocked country nestled in the Himalayas, faces the challenges of poverty, inequality, and limited access to financial services. Microfinance institutions have emerged as a critical solution to address these issues, offering financial services to the marginalized and disadvantaged populations.

Microfinance is a modern concept of financing that provides small business owners and entrepreneurs with access to capital, allowing them to manage loans, investments, and other financial services. It is targeted at low-income clients and includes loans, savings, insurance, transfer services, and other financial products and services. Microfinance is unique among development interventions as it can deliver social benefits on an ongoing, permanent basis, and on a large scale (Oli, 2018).

Microcredit, a subset of microfinance, refers to the extension of very small credit or loans to unemployed individuals, poor entrepreneurs, and those living in poverty who do not have access to formal banking. The goal of microcredit is to enable these individuals to raise their income levels and improve their living standards (Cull, 2018).

Microfinance services are provided by various institutions, including non-government organizations (NGOs), self-help groups, cooperatives, credit unions, commercial banks, insurance and credit card companies, and other points of sale. These services are designed to reach excluded customers, usually from poorer population segments, who may be socially marginalized or geographically isolated, and help them become self-sufficient.

The impact of microfinance and its ability to improve the livelihoods of borrowers depend on various factors, including the type of financial service provided and the specific needs of the borrowers (https://www.kiva.org/microfinance). Access to essential financial services can empower individuals economically and socially by creating self-reliance and economic sustainability in impoverished communities where salaried jobs are scarcehttps://finca.org/our-work/microfinance.

Problem Statement

The relevance of microfinance in Nepal stands as a critical issue necessitating in-depth analysis and examination. While microfinance has become a prevalent tool for poverty alleviation and economic development in various parts of the world, its applicability and impact in the unique context of Nepal present several pertinent challenges and questions that warrant comprehensive investigation.

Diversity in Geography and Demographics: Nepal is characterized by its diverse geographical landscape, with remote and hard-to-reach regions. Its population comprises various ethnic groups and socio-economic classes. The problem lies in understanding how microfinance can effectively cater to the financial needs of this diverse populace, accounting for their unique challenges and opportunities.

Historical Evolution and Policy Framework: The historical development of microfinance in Nepal has been influenced by government policies, the presence of non-governmental organizations (NGOs), and international models like the Grameen Bank. Analyzing the impact of this historical evolution on the current state of microfinance and its relevance is essential.

Poverty Alleviation and Economic Development: While microfinance is widely perceived as a tool for poverty reduction and economic growth, it is crucial to assess its actual impact in the Nepali context. The problem lies in understanding how effective microfinance has been in improving the livelihoods of the poor and fostering economic development.

Challenges and Regulatory Framework: The microfinance sector in Nepal faces challenges such as interest rates, sustainability, and regulatory issues. Understanding the root causes of these challenges and their potential solutions is essential for enhancing the sector's relevance.

Future Prospects and Innovation: As technology advances and financial products evolve, the problem lies in exploring the future prospects of microfinance in Nepal. This includes understanding how innovations in microfinance, such as digital solutions and new financial products, can contribute to the sector's continued relevance.

The statement of the problem underscores the need for a comprehensive analysis of the relevance of microfinance in Nepal, taking into account the country's unique context, challenges, and opportunities. This research aims to address these issues and provide insights into the role of microfinance in Nepal's socio-economic development evidenced from Dhakal, N. H. (2004), Forster, S. G. (2003), Ekpe, I. M. (2010) , Dhungana, B. T. (2022) and many more.

Research Objective

The paper aims to explore the historical development of microfinance along with impacts on development in Nepal.

Methodology

The methods of review used in this research paper encompass a multidisciplinary and comprehensive approach to gather and analyze relevant data. The following methods were employed:

Literature Review

Extensive review of existing literature on microfinance in Nepal, including academic papers, reports, and publications from government agencies, non-governmental organizations (NGOs), and international institutions. This literature review forms the foundation for understanding the historical development and current status of microfinance in Nepal.

Case Studies

In-depth examination of case studies from various microfinance programs and institutions operating in Nepal. These case studies provide empirical evidence of the impact of microfinance on poverty reduction, women's empowerment, and financial inclusion. They also illustrate the challenges and successes of microfinance initiatives through literature as grey review.

Field Observations

First-hand observations and interviews with microfinance practitioners, borrowers, and beneficiaries in Nepal. Field visits to urban and rural areas were conducted to gain a practical understanding of how microfinance operates on the ground and to assess its impact in diverse regions as informal social learning approach.

These methods were selected to ensure a well-rounded and thorough analysis of the subject, allowing for a comprehensive examination of the historical development, impact, challenges, and future prospects of microfinance in Nepal.

Results and Discussions

Nepal has a three-decade-long experience in microfinance, which is considered as a pro-poor and rural-based approach to poverty alleviation. The country's first step in microfinance was the initiation of agriculture-based cooperatives in the 1950s, with the Small Farmers' Development Program (SFDP) being transformed into Small Farmer Cooperative Limited, managed by the farmers themselves(Basnet, S. (2016). The success of microfinance in Nepal can be attributed to the following factors:

- **Targeting the poor and poorest of the poor:** Microfinance services in Nepal are specifically designed to cater to the needs of the poor, ensuring that they have access to financial resources that were previously unavailable to them(Nepal Rastra Bank.).
- **Significant contribution to socio-economic status:** Microfinance services have played a crucial role in improving the socio-economic status of the targeted communities in Nepal. By providing access to capital, these services have enabled small business owners and entrepreneurs to invest in their businesses, create employment opportunities, and generate income(Nelito. (2021).
- **Development of sustainable organizations:** Microfinance institutions in Nepal have demonstrated the ability to develop into sustainable organizations with steady-growing outreach within a few years. This growth has been facilitated by the demand for their services and their focus on meeting the needs of the poor and rural communities (Western Illinois University,2022).

Despite its success, microfinance in Nepal still faces challenges such as lack of accessibility to funds, extreme poverty, and difficult geographic conditions. However, the country's experience in microfinance has led to the development of various models, including the cooperative model, small farmer model, and self-help group model, which have contributed to its effectiveness in addressing the needs of the poor and rural communities.

Microcredit and microfinance are two types of fund-related activities that aim to increase access to financial capital for individuals and companies who don't have access to traditional financial services. Microcredit includes micro-level loans to clients, while microfinance includes a range of micro-level financial services such as microcredit, micro-saving, micro-insurance, payment transfer, provident fund, and pension. All types of microfinance intermediaries can provide all microfinance services, but NGO intermediaries cannot mobilize savings and provide other financial services like insurance, provident fund, and pension due to their legal status. Microcredit intervention is mostly done for the socioeconomic development of poor people, while microfinance interventions act as a tool for socio-economic development of poor people as well as a business proposition for microfinance institutions (MFIs). Microcredit can be considered as a part of microfinance, which includes the entire gamut of small-scale financial products and services meant for the poor and sections of people with no access to formal banking(FINCA International: Investopedia. (2023, September 23): Kiva. : Oxfam) . The main objectives of microfinance programs include providing easy access to microfinance for deprived, disadvantaged, and poor rural farmers and other sections of society, creating economic activities that uplift rural life, generating income and employment, creating social awareness and promoting community development, and achieving sustainable rural development and poverty alleviation (Enterslice. (2023, September 22).

Difficult topography, remoteness, heterogeneous groups and culture, etc., have hindered for the successful delivery of microfinance in Nepal. Principally, microfinance institutions pursue the income generating activities to promote the interest of the poor by providing basic services and contribute to upgrading their economic and social standard (Kumar, 2019). Figure1 shows the impact of microfinance on poverty reduction.

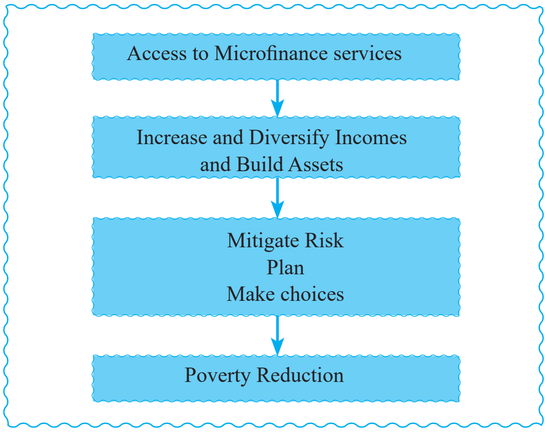

Figure 1: Impact of Microfinance on Poverty Reduction Source: (Bent, 2018)

Evolution of Microfinance in the World

Microfinance has a long history, dating back to the early 1800s when Jonathon Swift attempted to empower families in poverty through the Irish Loan Fund. However, the system was flawed and did not achieve its goal of financial independence for the rural population. In the late 20th century, Muhammad Yunus provided a small amount of his own money to a community in Bangladesh, which led to the founding of the Grameen Bank in 1983. The 21st century has seen notable achievements in microfinance, including the United Nations declaring 2005 the International Year of Microcredit and Muhammad Yunus winning the Nobel Peace Prize for microfinance in 2006. However, between 2008 and 2010, there was a microfinance crisis that affected developing countries heavily. The Universal Standards for Social Performance were developed to regulate the operations of microfinance organizations, and the Smart Campaign Client Protection Certification outlined the minimum standards of service that an organization could offer its clients. Despite the financial crisis, microfinance recovered quickly, with Opportunity's client numbers growing from 500,000 in 2005 to 3.5 million in 2015. In Nepal, microfinance has faced challenges due to difficult topography, remoteness, heterogeneous groups and culture, etc. (Kumar, 2019). The Bangladesh Rural Advancement Committee (BRAC), the largest NGO in Bangladesh, has been providing microcredit services since 1972, and it is planning a major expansion of its microcredit program to reach memberships of 4.0 million. Similarly, other developed countries where the microfinance model is gaining impetus include Israel, Russia, Ukraine, and 23 more, where microcredit is given to small business entrepreneurs to overcome cultural barriers in the mainstream business society (Haider, 2011).

Microfinance Policy in Nepal

The history of microfinance in Nepal spans over three decades, but prior to 2008, the government had not established an official microfinance policy (Oli, 2018). However, there has been a growing demand for microfinance services among the impoverished population in the country. In light of the remarkable success stories of countries like Bangladesh, India, the Philippines, Indonesia, Pakistan, and other developing nations in alleviating poverty through widespread financial services targeting the poorest rural and semi-urban communities, the Government of Nepal took the advice of the Nepal Rastra Bank and introduced the "National Microfinance Policy, 2008." This policy aimed to address organizational and legal challenges, enabling a seamless provision of microfinance services in rural areas, enhancing access for the destitute, fostering a competitive environment among Microfinance Institutions (MFIs), and encouraging private sector involvement in sustainable microfinance services.

The key highlights of the Microfinance Policy, 2008 are as follows:

1. Expand the supply of microfinance services to both rural and urban poor, tailored to their geographical, social, and economic diversity.
2. Facilitate the smooth provision of microfinance services, with or without collateral (group guarantee), to the impoverished by establishing a standardized procedure for identifying target groups.
3. Provide necessary support to microfinance institutions for social mobilization, capacity development, organizational restructuring, and encourage wholesale microcredit providers from both the public and private sectors.
4. Integrate microfinance with various poverty alleviation programs and projects, ensuring a coordinated approach.
5. Collaborate with institutions responsible for micro-enterprise development to assist targeted poor individuals in developing their enterprises.
6. Establish legal provisions for recognizing microfinance service providing institutions like Community Organizations (COs) and Savings and Credit Groups (SCGs).
7. Motivate the destitute to save and improve their access to microfinance services.
8. Create a separate institution under the direct control of the Nepal Rastra Bank to regulate and supervise Microfinance Service Providers (MFIs) for effective operation, monitoring, supervision, and evaluation.
8. Establish a "National Microfinance Development Fund" to mobilize resources for long-term, easy access to microfinance services, leveraging assistance from foreign and national donors.
9. Conduct a comprehensive survey to determine the current number of cooperatives and microfinance institutions, the extent of their services, and access to these services.
10. Organize training programs to enhance the capacity of individuals involved in the microfinance sector.
11. Implement a policy allowing savings deposits for MFIs based on the services provided and their share capital status.
12. Implement a flexible tax policy on the income of MFIs and tax on interest earnings of the impoverished.

It is worth noting that many of the initiatives and actions outlined in the policy have yet to be fully realized. The Nepal Rastra Bank, the central bank, is working on drafting a microfinance act and establishing a regulatory body for overseeing and supervising MFIs in Nepal (Oli, 2018).

Regulatory Authorities and Regulations

Nepal Rastra Bank (NRB) serves as the regulatory authority for all categories of banks and financial institutions that have received licensing under the Bank and Financial Institution Act of 2017. These institutions are classified as Class 'A,' Class 'B,' Class 'C,' and Class 'D' banks. Additionally, NRB exercises control and supervision over certain cooperatives that have been granted limited banking licenses. The NRB Act of 2002 defines NRB's responsibilities, which include the formulation of effective policies, the development of a secure and efficient payment system, the regulation and supervision of banking and financial entities, and the promotion of a robust banking and financial system. Furthermore, NRB operates a Microfinance Institutions Supervision Department, responsible for overseeing and monitoring microfinance institutions in Nepal. The functions of this department encompass:

- Conducting onsite inspections and supervision of microfinance institutions.
- Performing offsite supervision of microfinance institutions.
- Enforcing measures to ensure compliance with onsite supervisory reports.
- Engaging in activities related to access to finance and financial inclusion.
- Coordinating and facilitating various projects funded by different development partners (Oli, 2018).

Bank and Financial Institutions Act, 2017

The "Bank and Financial Institutions Act" (BFIA) of 2017 serves as a comprehensive framework that regulates various types of financial institutions. It classifies commercial banks, development banks, finance companies, and microfinance development banks into different categories, specifically Class A, Class B, Class C, and Class D institutions, respectively.

Under the provisions of the Bank and Financial Institution Act of 2006, a small Microfinance Development Bank (MFDB) can be established with a minimum paid-up capital of Rs.10 million to operate within three districts outside the Kathmandu Valley. To expand operations to cover 4-10 districts outside Kathmandu, an MFDB must raise its paid-up capital to at least Rs.20 million. For a national-level MFDB, the paid-up capital requirement increases to Rs.100 million. The MFDB can further extend its operations to additional districts by augmenting its paid-up capital, with an increment of Rs.2.5 million required for each adjoining district.Notably, the umbrella Act includes provisions that allow foreign banks or financial institutions to provide microfinance services in Nepal in collaboration with a Nepalese organization or citizen, or through a subsidiary organization that holds full shares. However, this activity necessitates permission from both the Nepal Rastra Bank (NRB) and the Government of Nepal.The Bank and Financial Institutions Act empowers the NRB with the responsibility to supervise, issue warnings to the Board of Directors, and take over management in the event of irregularities within a bank. Moreover, it enables the initiation of actions for liquidation when circumstances require such measures (Bank, 2017).Evolution of Microfinance in Nepal

The formal microcredit history in Nepal commenced in 1957 AD when the government established 13 credit cooperative societies. These cooperatives were set up to extend financial services to individuals affected by floods in the Rapti Valley of Chitwan district. The Government of Nepal, in collaboration with USAID, managed these societies. Microfinance has played a vital role in promoting income-generating activities among rural entrepreneurs by providing access to small loans and savings facilities.

The Nepali government's efforts to promote microfinance services can be traced back to 1974 when the NRB Central Bank of Nepal made it mandatory for two commercial banks to invest 5% of their total deposits in small sectors. This financial contribution was directed towards agriculture, cottage industries, and service sectors, collectively known as 'priority sectors.' In the 2077/78 monetary policy, Nepal Rastra Bank increased this requirement to 15%.

The growth of microfinance programs in Nepal began with the establishment of Nirdhan NGO in 1991 and Grameen Bikas Bank in 1992, marking the true inception of microfinance in its essence. Initially, microfinance programs were exclusively under government control, but now they are implemented by a range of entities, including government, semi-government institutions, and non-government finance organizations such as commercial banks, development banks, microfinance institutions, NGOs, and savings and credit cooperatives (Wijewardena, 2003).

In a developing country like Nepal, where the majority of the population still lacks access to proper financial services, microfinance and cooperatives have been designed to meet these needs. As of mid-July 2020 (Ashad end, 2078), there are 85 'D' class microfinance companies in Nepal, with 45 of them operating at the national level. These microfinance companies in Nepal are categorized into wholesale and retail microfinance. Wholesale microfinance provides loans to individuals who lack financial support, while retail microfinance sources funds from banks or wholesale microfinance and extends loans to low-income individuals. The primary objective of microfinance institutions in the country is to provide access to finance for both bankable and entrepreneurial individuals. However, a challenge within the microfinance sector in Nepal is its concentration in urban areas.

To address this issue, NRB has been encouraging microfinance institutions to consider mergers and acquisitions (Shrestha, 2009).

Microfinance Models

Nepal boasts several prominent models of microfinance. These encompass the Cooperative model, SFCL model, Grameen Bank model, and Community-based Organizations (COs) or Self-Help Groups (SHGs) model. Additionally, specific programs such as Production Credit for Rural Women (PCRW) and Village Banks are recognized as distinct microfinance initiatives within Nepal. Programs like the Decentralized Local Governance Support Program (DLGSP), Poverty Alleviation Fund (PAF), and various rural development programs have also incorporated microfinance components, typically based on the SHG model. It's important to note that each of these models has its own unique historical background and operational approach (Vetrivel, 2010).

Cooperative Model

In 1991, the government of Nepal introduced the Cooperative Act of 1992, allowing a collective of 25 individuals from a community to establish a cooperative by registering with the Department of Cooperatives, Ministry of Agriculture and Cooperatives. Notably, Savings and Credit Cooperatives (SCCs) operate independently from the regulatory framework of the Nepal Rastra Bank (NRB). However, there are some cooperatives that have acquired licenses from NRB to provide limited banking services, thereby subjecting them to NRB's regulation and oversight. SCCs have the flexibility to serve all members of a community, irrespective of their social and economic status. Typically, these cooperatives are initiated by groups of 25 individuals within their respective localities or villages. Presently, SCC membership is predominantly composed of individuals from relatively affluent families who can afford to save, with an average membership size of around 100 members per cooperative.

Small Farmer Cooperative Limited (SFCL) Model

With the support of GTZ - German Technical Cooperation, an initiative was launched to transform the Small Farmer Development Program Sub-Project Offices (SPOs) into Small Farmer's Cooperatives in Nepal. This institutional development began in 1988 as part of GTZ's Rural Finance Nepal Project (RUFIN). In 1993, four SPOs in Dhading district became the first to register as Small Farmer Cooperative Limited (SFCL). As of now, there are more than 228 SFCLs in 41 districts, comprising 139,368 members and 111,494 borrowers. Among them, 11 SFCLs are entirely managed by women, and 219 SFCLs are affiliated with the Sana Kisan Bikash Bank Ltd. (SKBBL), a bank established in 2001 to provide wholesale finance to SFCLs. The SFCL model has received recognition, earning the CGAP/IFAD Pro-Poor Innovation Challenge Award in 2003 for its effectiveness in poverty alleviation.

The SFCL has a three-tier structure. Promoters at the village level facilitate the formation of local household groups. At the ward level, these farmers' groups, sharing common interests and proximity, are integrated into intergroup associations. At the VDC (Village Development Committee) level, all groups and intergroups are represented in the Executive Committee. This Executive Committee, formed from members elected by the General Assembly, is responsible for hiring the Manager and other staff and for establishing the necessary rules and regulations to ensure the efficient operation of the organization. Grassroots groups hold regular meetings to collect mandatory savings and loan repayments and process loan applications. These applications are then forwarded to their respective intergroups for appraisal and recommendations before reaching the Executive Committee for the final decision.

SFCLs typically operate within a single VDC area and primarily serve small farmers. Most of the loans they extend require collateral security, although some loans are offered without collateral, although these account for less than 10% of the total. On average, each SFCL serves approximately 500 households. SKBBL provides wholesale loans to 219 SFCLs, and about 60 SFCLs have demonstrated strong performance, generating substantial internal resources and conducting annual transactions ranging from Rs.40 to 60 million. Despite their financial stability, some SFCLs continue to borrow modest sums from SKBBL to maintain good relations. In some cases, SFCLs also offer loans exceeding the Nepal Rastra Bank's defined ceiling of Rs.150,000 to retain clients and promote enterprises.

Grameen Bank Model

The Grameen Bank lending model, developed by Professor Muhammad Yunus in Bangladesh, was introduced in Nepal during the 1990s. The Government of Nepal (GON) and the Nepal Rastra Bank (NRB) established five regional Grameen Bikas Banks (GBBs), one in each of the five development regions. Simultaneously, two national-level NGOs, Nirdhan and the Centre for Self-help Development (CSD), initiated microfinance programs based on the Grameen model. Later, they also established two microfinance development banks, Nirdhan Utthan Bank Limited (NUBL) in Bhairawa and Swablalmban Laghubitta Bank Limited (SB bank) in Janakpur, both adopting the Grameen model. Other prominent NGOs like Chhimek, DEPROSC, NRDSC, FORWARD, and Jeevan Bikas Samaj (JBS) followed suit by starting their microfinance programs based on this model. Currently, GBBs, Private Microfinance Banks (PMFBs), and numerous Financial Intermediary NGOs (FI-NGOs) and Savings and Credit Cooperatives (SCCs) are also providing microfinance services to the poor, following the Grameen model.

The success of this model is more pronounced in areas with developed markets, road infrastructure, and vibrant economic activities. It is more feasible in the Terai region than in the hills and mountains. The model is based on forming peer groups, with each group comprising five members. Three to ten of these peer groups establish a center at a specific location, often near a village, where they convene on a weekly, biweekly, or monthly basis as determined by the members. Each group elects a chairperson, and each center appoints a center chief to oversee group activities, maintain discipline, monitor loan utilization, and ensure timely loan repayment. During these meetings, group members collect savings, request loans, and manage loan repayments and interest payments according to the schedule. Collateral security is not required for loans, but group guarantees for repayment are essential.

To begin, potential target groups are identified using Participatory Rural Appraisal (PRA) techniques or Participatory Wealth Ranking (PWR) exercises. Once target groups are identified, eligible members undergo a weeklong pre-group training (PGT) or a compulsory group training (CGT) on microfinance procedures, group organization, and center operation. Field staff from the Microfinance Institution (MFI) facilitate biweekly or monthly meetings, where they collect mandatory and voluntary savings, loan repayments, and loan requests. They also verify loan utilization. While the GBBs still adhere to the traditional Grameen Bank model, replicating Private Microfinance Banks and FI-NGOs have adjusted the model to suit their local conditions and requirements. Some of the institutions following the Grameen Bank model have diversified savings schemes, including education savings, pension fund savings, and micro-insurance covering risks related to loans, life, health, and livestock, as seen in the Grameen Generalized System (GGS). Certain dynamic groups also address social problems and community-related issues and take necessary actions to resolve them.

Self-Help Groups (SHGs)/Community Organizations (COs) model

In Nepal, informal self-help groups come in various forms, including 'Dhukuti,' mothers' groups, and other groups with specific objectives.

These informal self-help groups are not necessarily focused on addressing poverty and typically involve individuals from the lower-middle or middle-class strata. A particularly popular type of informal self-help group is the 'Aama Samuha' or mothers' group. These groups are primarily initiated and operated by local women, with objectives related to income generation, addressing social issues, and fostering positive societal change. Empowering women is a central goal of most mothers' groups. They engage in campaigns against issues like alcoholism, gender injustice, girl trafficking, and other social problems. Moreover, they pool their savings and provide credit to members in need, although their focus is not exclusively on serving the poor. Mothers' groups are prevalent in hilly and mountainous regions and have been in existence for more than three decades. While they were extensively practiced in the hills and mountains of the Western Development Region, these groups are not officially recorded.

Rural development programs also establish Community Organizations (COs) or Self-Help Groups (SHGs) to facilitate community participation in their initiatives. These programs prioritize poverty reduction through local capacity building, as seen in projects like the Decentralized Local Governance Support Program (DLGSP) and the Poverty Alleviation Fund (PAF). Typically, SHGs and COs engage in savings and credit activities to support enterprise development and enhance livelihoods. In DLGSP, COs receive counterpart funds as seed money to provide financial assistance to their members for implementing economic and entrepreneurial programs. These projects also offer various training programs to enhance the capabilities of COs. Some development agencies have transitioned these groups into savings and credit cooperatives by registering them with the Department of Cooperatives. However, many remain informal and become non-functional after the projects conclude. Moreover, they often struggle to establish connections with formal financial institutions due to their lack of legal status.

The 'Dhukuti' system is a longstanding self-help group in Nepal that has been in operation for over four decades. This system involves closely affiliated and well-acquainted individuals forming a group and contributing a specified amount at predetermined intervals. During each collection meeting, the pooled funds are provided to a member in need, following rules established unanimously by the group. While these rules are typically unwritten, they are collectively agreed upon during the group's initial meeting. The member who has received the funds continues to contribute the designated amount until all members have had the opportunity to use the pooled money in each session. This approach emphasizes that small contributions from all members can enable one needy member to access a substantial sum, which can be used for income-generating activities, ultimately fostering economic development. It's essentially a self-help strategy for the development of group members. Those who access the funds earlier can benefit more from the time value of money, and, in this system, members do not pay interest. Depending on their rules, early users may receive slightly less than the total collected, while the last person to use the funds may receive their entire deposit or even a bit more. Members may also decide to enjoy any surplus funds by organizing picnics or lotteries, providing surprise prizes to the lucky winners.

The Local Development Fund (LDF) under programs like PDDP and DGLSP assists local communities in organizing Community Organizations (COs) or Self-Help Groups (SHGs) in various settlements within the Village Development Committee (VDC). COs are established for separate groups of men, women, or both, and they mobilize compulsory and other forms of savings. Typically, they charge 10-12% annual interest to borrowers under their lending schemes. COs hold regular meetings where members apply for loans and collect due installments. They also establish interest rates and other loan terms and conditions if they lend money from their own savings. When a member requests more funds than the CO can provide from its savings, they must submit a separate application addressed to the Local Development Fund (LDF). The CO recommends the loan and forwards it to the LDF for approval. Similarly, the Poverty Alleviation Fund (PAF) also organizes local groups known as COs, comprising target families, in collaboration with local NGOs. These groups receive a seed fund of Rs. 3,000 per family member. These are informal groups not linked with any financial institutions and typically charge around 12% annual interest on their loans.

Village Bank Model

The Village Bank (VB) model, originating from Latin America, was introduced in Nepal between 1998 and 2001 through the USAID-funded Women Empowerment Project (WEP) implemented by PACT-Nepal. Village Banks are grassroots-level financial institutions, community-managed savings and credit associations designed to provide financial services to women in the community by mobilizing their own resources, ultimately promoting financial self-reliance. PACT Nepal collaborated with local NGOs and cooperatives to promote these banks, primarily in the Terai region of Nepal. The project also provided loans to establish the external account of the VB, which was then lent to its members. However, these banks were not integrated with formal financial institutions, and many of them became non-operational after the project's conclusion.

A typical VB comprises 40-50 women and begins with a six-month literacy class that also teaches the savings and credit operation process. Subsequently, the VB mobilizes members' savings to provide loans for both productive and consumption purposes to women in need and supports capacity-building for the banks. Members generally receive loans ranging from Rs. 3,000 to 10,000 each time, depending on the available savings in the Village Bank. The loan cycle must conclude at the end of the 16th week, with all loans being repaid to access new loans. This practice is referred to as "zero gathering," where old loans are settled, and new loans are issued, resulting in a zero balance. Savings deposits do not earn interest, but at the end of each loan cycle, profits are shared proportionally with members based on their savings deposits. These benefits are allocated as savings to the corresponding accounts, provided the minimum balance is maintained for at least nine weeks, rather than distributing cash to the member depositors.

Village banks typically charge 24% annual interest, collected upfront. The management of VBs is overseen by elected officials such as the chair, secretary, and treasurer, who maintain records, minutes, and accounts. All documents are stored in a triple-locked tin box, with all three officials having access. These processes ensure transparency to the members. During the project, these VBs were not connected to formal financial institutions. However, some VBs have been linked with a Savings and Credit Cooperative (SCC) in the Nawalparasi district with support from RMDC loans (Barr, 2007).

Microfinance and its role in skill development

Microfinance has grown rapidly as a sector throughout the world and is widely recognized as a valuable instrument to combat financial exclusion of poor communities. Microfinance has attracted interest as a strategy for reducing poverty for several reasons: it has rapid, massive, and verifiable effects; it can be measured and evaluated; it can often be scaled up quickly; it can be targeted with precision at the poor and sometimes even the very poor; microfinance recycles financial resources generated in the local economy (unlike grant or transfer-based programs in poverty reduction). Above all, microfinance empowers it is a catalyst for organizing, and also treats the poor as autonomous, responsible individuals who are expected and want to take charge of their lives.

While microfinance is generally recognized to have positive income stabilization effects on the self-employed and micro enterprises in the informal economy, much less is known about the impact of microfinance on supporting the move out of informality. It is likely there is a strong link because loan, deposits and other service contracts contain elements of the formal economy, without being at the same time as sophisticated as mainstream bank services. Also, in order to grow microfinance institutions, encourage their clients to grow themselves from livelihood activities to genuine microenterprises, and from these to small and medium enterprises. Fem aspects like education on microfinance with ethics and digitalization can reestablish the significance of it(Mishra, A. K., Ananda, N. (2022):Mishra, A. K. (2023): Mishra,

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Conclusion

The inception of formal microcredit in Nepal can be traced back to 1957 when the government established credit cooperative societies. These early initiatives were instrumental in providing financial services to those affected by natural disasters, marking the beginning of a formal microfinance landscape in Nepal.Government Interventions and Policies: Over the years, the government of Nepal has played a significant role in shaping the microfinance sector through policies and regulations. The introduction of the "National Microfinance Policy, 2008" by the Ministry of Finance and the Nepal Rastra Bank was a crucial step in promoting a healthy and competitive environment among microfinance institutions (MFIs).The Role of NGOs: The emergence of non-governmental organizations (NGOs) as microfinance providers has been a transformative force. The adoption of the Grameen Bank model in Nepal has expanded access to financial services, particularly in remote areas, empowering women and improving livelihoods. Impact on Poverty Reduction: Microfinance has proven to be an effective tool for poverty reduction in Nepal. By expanding access to financial services and providing small loans for income-generating activities, it has significantly contributed to improving the living standards of the marginalized population.Challenges in the Microfinance Sector: The microfinance sector faces challenges related to interest rates, sustainability, regulatory frameworks, and outreach. Striking a balance between financial sustainability and avoiding over-indebtedness among borrowers is a key challenge. Future Prospects and Relevance of Microfinance: The future of microfinance in Nepal holds promise. It has the potential to stimulate economic growth, particularly in remote and underserved areas. Innovations in microfinance, such as digital solutions and new financial products, are expected to further enhance its relevance.

Microfinance remains a critical instrument in Nepal's development journey. Its significance in poverty alleviation, financial inclusion, and economic growth cannot be overstated. The continued support and innovation in the microfinance sector are essential to maximize its impact.To ensure the continued relevance and effectiveness of microfinance in Nepal, several recommendations are proposed. These include enhancing regulatory frameworks to promote responsible microfinance, promoting financial literacy and education, and encouraging public-private partnerships to scale up microfinance initiatives. These measures are crucial for realizing the full potential of microfinance in Nepal's quest for sustainable development and poverty reduction.

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