Microcredit programs and their challenges in Nepal

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Abstract

Microfinance has been introduced to combat extreme poverty and enhance economic development in many third world countries. This paper gives an overview of the emergence of microcredit programs in Nepal and their potential for socioeconomic empowerment of the poor. Additionally, their effectiveness in uplifting rural Nepalese societies and the challenges they face are discussed. Extreme poverty, gender gap, and unfavorable small business climate are some of the major reasons behind limited success of microcredit programs in Nepal. My recommendations for improving their success and outreach are: targeting poorest of the poor by expanding microcredit programs to all topographical regions, implementing different strategies based on geography and poverty level, providing complementary support for women empowerment, and designing policies aimed at supporting small businesses.

1. Introduction

We live in a world where the gap between the extremes of financial sufficiency is wider than ever before. On one end are the ultra-rich who can ensure access to the best healthcare, food and education for several generations after them and on the other end are the ultra-poor who wake up every morning unsure if they will have enough to eat that day. Despite the technological and medical breakthroughs of the past century, the gap between the rich and the poor continues to increase, and poverty remains the greatest challenge to the modern world. The human development report by UNDP states that about 46% of people in Sub-Saharan Africa, 32% people in South Asia and 10% of people in Latin America & Caribbean are income-poor (UNDP, 2005). Approximately 1.3 billion people all over the world live on income of less than $1 a day (UNICEF, 2007). More than 110 million children of primary school age have never stepped inside a classroom and more than 840 million adults still remain illiterate (Woller, GM and Woodworth, W, 2001). More than a third of all children in developing countries are malnourished, and approximately 29,000 children under the age of five die each day from preventable diseases and malnutrition (UNICEF, 2007).

Various strategies have been employed in different parts of the world to reduce poverty and improve health and literacy. Microfinance is one such strategy that has been popular and successful in many third world countries. As I will discuss in this paper, microfinance has indeed helped people out of poverty and touched the life of “poorest of the poor” families around the globe. However, the success rate of microfinance isn’t the same everywhere. In Nepal, microfinance hasn’t been as successful as it has been in some parts of the world. It is my goal in this paper to illustrate and discuss the cause of the comparatively poor effectiveness of microfinance initiatives in Nepal.

First, I will present an overview of microfinance and the socioeconomic condition of Nepal. Second, I will discuss the emergence of microcredit programs in Nepal and their potential for socioeconomic empowerment of the poor. Finally, I will address the challenges faced by microfinance institutions (MFIs) in Nepal and recommend some measures to overcome those challenges. I will also present some case studies of microcredit borrowers in Nepal. These case studies are based on first-hand interviews with the subjects and telephone interviews with MFI officials that I conducted during my visit to Nepal in January 2007.

2. Background

2.1 Microfinance

Microfinance has been established as a key developmental tool for poverty reduction in many countries around the world including Bangladesh. The concept of “banking the un-bankable” championed by the Grameen Bank of Bangladesh has now been adopted by many third world countries. The major goals of the Grameen bank can be summarized as follows:

- Reaching the poorest
- Reaching and empowering women
- Building financially self-sufficient institutions
- Ensuring a positive measurable impact on the lives of the clients and their families.

(Daley-Harris, S, 2002)

Microfinance constitutes a circle of borrowing, saving and investing in order to help the poor climb out of poverty. It is designed to meet the needs of the poor with a very low interest rate and no collateral requirements. The size of loans range from less than $20 to a few hundred dollars, depending on the borrower’s business or investment plans. Since the loan requires no collateral, it is accessible even to the poorest person. According to the Consultative Group to Assist the Poor (CGAP)[1], 50-60 % of first-time borrowers in several countries were in the bottom third of their community and even more were living on less than $1 a day (Daley-Harris, S, 2002). This truly reflects the potential of MFIs to reach the poorest people in any community. Microcredit programs not only help families move out of poverty and improve their standard of living, but also serve as “bottom-up” tools for socioeconomic development of a nation (Roy, AM, 2003). In fact, the Grameen Bank and its founder, Muhammad Yunus, were both awarded the Nobel Peace Prize of 2006 for employing microfinance as a bottom-up strategy for economic and social development (Nobelprize.org, 2006).

[1] Consultative Group to Assist the Poor (CGAP) is an organization that comprises of 33 public and private development agencies that work together to help the poor gain access to financial services in developing countries.

Hundreds of MFIs have been established all around the world based on the principles embodied by the Grameen Bank. Studies indicate that such MFIs have been acting as developmental agents in the eradication of poverty and empowerment of women in many parts of the world (Roy, AM, 2003). However, the impact of MFIs has not been equal in all nations. In some countries, despite the introduction of MFIs, there are still large fractions of the population of poor people that have not derived direct or indirect benefits from such programs. Nepal is one such country.

2.2. Nepal: a socioeconomic overview

Nepal has an annual per capita income of US $200, which makes it the tenth poorest country in the world (UNDP, 2007). More than 31.8% of the total population of Nepal lives below the poverty line (The World Bank, 2007). While extreme poverty is still one of the biggest challenges Nepal faces, there is also a need for social reform to end discrimination against women. From birth, women in rural areas are bound by strict social norms (Singh, J, 2002). Women from many rural families are bound to spend most of their life maintaining the household, working in the fields and collecting firewood. Only the lucky few complete high school, and a large percentage of the women who can read or write go on to spend the rest of their lives as housewives (Singh, J, 2002). In rural Nepal, most males, who are the sole breadwinners for their families, work on lands owned by one of a few rich village landlords. The pay is often insufficient to support the families' basic needs for a whole year. They make up for the insufficiency by raising and selling chickens, goats and milk from cows. Due to lack of savings, it is hard for the poor not only to be prepared for medical emergencies, but also to escape poverty on their own. Male children in the family often inherit their father's debt and place of employment.

This cycle of working on lands owned by landlords and struggling to save money continues for generations. The case of the ‘Kamaiya’ system in western Nepal is a classic example (GEFONT, 2007).

Nepal has three different topographical regions: the Himalayan mountains, the high hilly region (pahad) and the plain, flat land (terai). Almost one third of the land is covered by mountains and holds only about 5% of the total population. About 42% of the total land area is covered with high hills and holds about 40% of the total population (Bhatta, Gambhir, 2001). Agricultural output from both of these regions is negligible. Due to the difficulty of building and maintaining infrastructures, industrial output is minimal. The terai – the area of flat land – holds a little over half of the population (Bhatta, G, 2001). Due to availability of fertile land and accessibility of transportation, this region is the most developed part of the nation in terms of trade and monetization. This is also where the majority of microfinancing in Nepal has taken place (Development Project Service Center and Ledgerwood, J, 1997).

The past decade has seen tremendous political, economic and social upheaval in Nepal. Due to an armed conflict between the Maoists and the government, the country has frequently been paralyzed by curfews, strikes and uprisings. These disturbances have deepened the economic hardships of the poor. Inflation, unemployment, corruption and crime have grown out of control. Unemployment hit 42 percent in 2002 in Nepal (The World bank, 2007). Development efforts – microfinance programs included – have suffered from this instability.

2.3 Microfinance in Nepal

History

Since Nepal is an agriculture-based nation in which more than 76% of the labor force participation is in agriculture, agriculture-based programs such as Credit co-operatives were initiated as a first step in microfinance in the 1950s with the aim of providing credits to poor villagers for agriculture purposes (Center for Microfinance, 2007). Several other organizations such as the Small Farmers Development Program (SFDP) were started under Asian Development Bank/Nepal (ADB/N) in 1975. The Intensive Banking Program (IBP) was established in the year 1981 with an aim of providing larger amount of loans to all types of workforce, and tried to involve commercial banks in microcredit (Centre for Microfinance, 2007). In 1992, the Grameen Bank's model of microfinance was adopted in Nepal. Several other microcredit organizations were opened later on by the Central Bank as well as the government of Nepal (Center for Microfinance, 2007).

Current state

Many MFIs have been established in Nepal with the mission of providing financial services to the poor. Commercial banks, development banks, NGO Banks and community-based finance companies are the four major institutional sources of microcredit in Nepal. Financial intermediaries like Savings and Credit Co-operatives, Savings and Credit Groups, and Traditional Savings and Credit Groups are also involved in providing microcredit to the poor (Center for Microfinance, 2007).

The microfinance market in Nepal can be divided into three sectors: the formal sector, the semi-formal sector and the informal sector. The formal sector comprises of 17 commercial banks, 10 development banks, 57 finance companies and 9 rural microfinance banks (ARCM, 2007). Approximately 2300 savings and credit cooperative societies and 44 financial intermediary NGOs form the semi-formal sector. The informal sector is comprised of innumerable community-based organizations and individual or group programs like *dhikuti*, traditional group formations popular in ethnic trading communities for savings and credit purposes; *dharam bhakari*, grain associations in which each member provides an equal contribution of grain at harvest time and can draw from it in times of need; and *guthi,* similar to *dhikuti* but the funds are used for community welfare activities (ARCM, 2007). A joint venture of more than 4000 NGOs (Non-governmental organizations) and seventy INGOs (International NGOs) have launched more than 9,000 savings and credit companies in total around the country, which add up to millions of dollars of financial assistance from donor countries and institutions (Rankin, NK, 2001).

The potential of MFIs to contribute to socioeconomic empowerment of the poor

A well-planned MFI based on the principle of "banking the unbankable" and empowering women can really help a country like Nepal that is going through a "twin crisis" of political and economic instability. It takes years before most development plans reach their goals. Microfinance, however, is one key developmental tool that reaches its goal in a short time if planned carefully. It also serves as a base for meeting other developmental goals like education, health care, and nutrition.

The fundamental goal of MFIs in Nepal is to increase the living standards of the entire population, especially the 31.8% of the population that lives below the poverty line (The World Bank, 2007). It should be noted that even with almost one third of the population living below the poverty line, almost 40% of Nepal's GDP flows from poverty sector labor and trade (Douglas, RS and Buss, FT, 2001). It has also been found that the informal sector dominates the credit scene in villages (Bhatta, G, 2001). Such informal sector initiatives do not include contributions by the microcredit programs. According to some reports, about 60% of all work hours in developing countries are derived from the informal sector (Douglas, RS and Buss, FT, 2001). Microcredit programs are thus in a position to directly influence the productivity of the nation by improving the ultra-poor's access to the informal sector.

Recent studies suggest that, with the assistance of financial services and economic opportunities, the very poor can lift themselves and their families out of poverty (Woller, GM and Woodworth, W, 2001). However, since they can be high credit risks, the formal credit market discriminates against the very poor. In fact, the lack of substantial property that can be used as collateral cuts off their access to the majority of the loans provided by the formal credit market (Woller, GM and Woodworth, W, 2001). Since microcredit is designed so that the very poor can have access to it, it allows the very poor to work their way out of poverty over time.

Moreover, an effective MFI can exhibit a significant multiplier effect. The income, investment and savings generated by an MFI can increase the circular flow of cash within the country, thereby increasing GDP.

3. Challenges faced by MFI in Nepal

Any movement targeting a large population and goal will always have its instances of failure and success. The microcredit movement is given impetus by success stories in Bangladesh, India, South America, and Africa. These experiences have helped establish microcredit programs as a promising development strategy in the eyes of many policymakers.

However, in the case of Nepal, there are still major challenges that have caused inefficiency and limited the reach of the microfinance industry. Some of the reasons behind such failures are internal. Some MFIs focus on agricultural lending while ignoring small nonagricultural enterprises, which prevents risk diversification and income growth. Other failures are driven by cultural misconceptions: subsidized interest rates are often perceived as governmental credit disbursement rather than the policies of self-sustaining financial institutions, which results in weak incentives to repay the loans.

The inefficiencies of microcredit programs become evident when their outreach is put in the context of the entire population or the population living below the poverty line. More than Rs. 20 billion (about $285 million) has already been invested in microcredit programs in Nepal. More than 433,000 households have received collateral free loans and the total number of borrowers has reached approximately 2.2 million (ekantipur, 2005). Even though these numbers look big, they aren’t very impressive given that the total population of Nepal is about 29 million and approximately 32 percent of the population (about 9 million) lives below poverty line (The World Bank, 2007). That means, microcredit programs have reached less than 25 percent of the population living below poverty line. The poverty line of Nepal is an earning of $0.21 per day (Khadka, R. Sarba). Out of the 2.2 million people reached by microcredit organizations, less than 450,000 earn less than $1 a day (ekantipur, 2005). This means that only a small fraction of the 2.2 million that has been reached can really be categorized as poor. Also, almost half of the total population of Nepal is women, i.e. almost 15 million (Bhatta, G, 2001). However, out of the 2.2 million people reached, only 39,000 are found to be women borrowers (ekantipur, 2005). These data indicate two important things about the effectiveness of microcredit programs in Nepal: first, the population that has so far been reached is primarily medium-poor population rather than the very poor population of Nepal, who need the assistance of microcredit programs the most. Second, microcredit programs in Nepal have not been very successful in reaching women.

The fact that microcredit programs in Nepal have not been as effective as they should be becomes even more apparent when their performances are compared with the case of a successful country like Bangladesh, where more than 75 percent of poor families have received assistance from microcredit organizations covering almost 90 percent of villages, and more than 95 percent of borrowers are women (Grameen, 2007).

The poverty rate of Nepal declined from approximately 42 percent to 31 percent from the year 1995/96 to 2003/04 (BBC News, 2005). Decline in poverty was greater in urban areas than in rural areas during this period. However, Gini coefficient, a measure of income inequality, has increased from 34.2 to 41.1 in the same period in Nepal (The World Bank, 2006). This means that the gap between the rich and the poor has also increased despite the reduction in poverty. An interesting question to ask is how much of the poverty decline or widening of income inequality is due to microcredit programs. Of particular importance is the fact that, in the past decade, the number of Nepalese workers going abroad has dramatically increased (The World Bank, 2006). As a result, remittance earnings have increased by almost seven fold in the same period when reduction in poverty was seen (The World Bank, 2006). This increase in remittance could be a major contributor to the decline in poverty. Indeed, the World Bank has identified increase in remittance as one of four factors that could have played a role in poverty reduction in Nepal (The World Bank, 2006). Interestingly, microcredit programs are not in the list of four factors.

Here, I have identified and will discuss three major challenges to the success of Nepalese MFIs. These are partly based on my own research conducted in January 2007, which consisted of case studies of families who reside within Nepal and have directly or indirectly been impacted by MFIs. Since the number of case studies that I conducted is relatively small, I do not claim that these studies are representative of the overall population of Nepal. I have therefore gathered information and drawn insights largely from pre-existing studies published in well-known journals or by well-established institutions like the UN and UNICEF. Accordingly, I propose that some of the major challenges faced by microfinance programs in Nepal are as follows:

1. Extreme poverty
2. Gender gap
3. Unfavorable small business climate

3.1. Extreme poverty

Nepal is an extremely poor country. Majority of the people in the hilly areas of Nepal rely on agriculture for subsistence. Due to lack of funds to finance new technologies, they continue to use traditional farming methods. As a result, productivity is low and savings are nominal. Many unemployed people, especially of the younger generation, could use funds in the form of microcredit to start new ventures, which would allow them to be self-employed and independent. Microcredit would help them support their family without borrowing money from landlords or working as agricultural laborers. Although microfinance programs have existed in Nepal for several years now, accessibility to the program’s offerings by the poor is a major challenge. As stated earlier, the majority of the microfinance programs is concentrated in terai (the flat lands) and has not reached many of the poorest of the poor of Nepal. The availability of microfinance programs in the hilly regions has been restricted to urban centers that are inaccessible to the extremely poor, largely due to either lack or high cost of transportation (personal interviews). Even the people in the terai regions and urban centers of the hilly regions who have utilized microfinancing programs have not achieved the full goals of microfinancing. A portion of microcredit borrowers remain trapped in poverty. Many of these borrowers were, of course, extremely poor to begin with. Extreme poverty not only prevents the poor from gaining access to financial help from microcredit institutions, but also limits what they can gain from microcredit if they have access to it. There are two ways in which extreme poverty can cause such outcomes:

a) Lack of savings:

MFIs provide credit to the poor which the poor can invest in the formal or informal sector to generate income. A good indicator of a successful investment is the savings generated. Microfinance programs in Nepal have largely failed to help the borrowers manage their savings. My research in Bandipur (a small village town in Tanahun district) suggests that those who have received some form of help from microcredit programs use the minimal savings they generate for emergencies at home or day-to-day purchases. According to some people, there are instances in which the savings of borrowers are 'seized' in excess amounts by rich people of the village as repayment for past loans[2]. When savings are not reinvested in the market but are rather spent on food, clothing, etc., the living conditions of the borrowers might only improve in the short run. In the long run, when the loans are repaid to the microcredit provider, the borrower basically ends up at the same socioeconomic level as before. One might argue

[2] According to the villagers, borrowing money at high interest rates from rich people in the village was the only source of credit in the years before microcredit became available. Villagers used this alternative only during emergencies and special occasions like the wedding of their children.

that if the borrower has the impetus to save and reinvest, he or she can do so without access to a savings bank. Unfortunately, social and cultural factors appear to make this more difficult than we can imagine. Below, I describe two case studies that speak to this difficulty.

> Ram Kumari Tamang, a mother of four children and the wife of an alcoholic husband, had received about $20 as a loan from a microfinance company. She bought a sewing machine and opened her own small tailoring shop in her home. She was quite happy with the money she was making. Even though her income was nominal, it helped her cover her day-to-day living expenses. She also saved some money every month, which she hid in her house with the hope of buying another sewing machine. Her plan was to train her daughter, who was 16, to use the second sewing machine and thus expand the business. Her husband, however, was an alcoholic. He stole Ram Kumari's savings when he found out where she hid them. He would often beat her and the kids to get the money to drink. In this way, Ram Kumari could not save much money, as her husband would get it from her in any possible manner. She didn't trust anyone else enough to hide the money outside her home. According to Ram Kumari, she would be able to save the money if there was a local bank or savings institution. This would also give her more confidence to fight against her husband, as he would not have access to the money deposited in the institution.

Another case that provides insight in to the lack of savings involves a microfinance company located a few kilometers from Hetauda, a major industrial city in the terai region.

> In a phone interview, the manager of the company explained to me how villagers from villages surrounding the city are benefiting from their microfinance program. However, he mentioned the same problem that Ram Kumari had been facing. Since their company doesn't have any program to help the borrowers safeguard and mobilize their savings, many of his clients expressed dissatisfaction at the lack of support for the borrower's businesses. He was also told by many villagers that the money they kept at home was either seized by the rich people of the village or are taken away by their own spouse or even their in-laws. This problem was more pronounced with female borrowers.

MFIs are not entirely to blame for the lack of savings in rural areas. The lack of governmental banking institutions within easy reach of the poor is also a problem. Because of political problems in the past few years, the number of governmental banks is decreasing, not increasing, and rural areas had very few banks to begin with. Many of these few banks have been forced to shut down due to looting and the threat of destruction by the Maoists[3].

Another reason for lack of savings in rural areas and in turn a reason for extreme poverty was found to be consumption expenditure. Due to extreme poverty, most of the people in rural areas of the country struggle for day-to-day living expenses. 50-90 percent of formal and informal credits received by these poor populations are used in consumption expenditure instead of investing in new businesses (Sharma, M and Zeller, M, 2000).

Some case studies I conducted in rural areas also point to this problem of lack of savings caused by consumption expenditure. Even with a high repayment rate of 40-100 percent for MFIs (Center for Microfinance, 2007), I found a startling trend in the use of loans. Some of the borrowers of microcredit organizations were using a significant portion of the loans for day-to-day expenses instead of investing in new businesses, thus putting themselves in debt. In order to pay the debt of the first microcredit organization, the borrowers took loans from another microcredit company, using some portion of it again for consumption expenditure and some to pay their debt with the first microcredit organization. In this way, they were trapped in a never-ending cycle of borrowing and repayment, leaving them with neither investment nor savings. While only a subset of microcredit borrowers of Nepal might fall under this category, these examples

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[3] As an example of how the Maoists are effecting the banking sector, read this news: http://www.nepalitimes.com/issue/71/FromtheNepaliPress/7442

nevertheless highlight how poverty itself can be a hindrance in the use of loans provided by MFIs.

Even for people who do invest the loans and earn money from their micro-businesses, their savings are spent either in loan repayment or as consumption expenditure. On a local level, this lack of re-investment prevents financial growth of the borrower's business or household. On a larger scale, the failure to save has a direct effect on the economic condition of the nation. Money deposited in a bank could be circulated, increasing the velocity of money. This in turn would lead to higher multiplier effect, thereby contributing to economic development. For instance, savings of villagers could be used to build infrastructure like roads, health centers, schools, and drinking water supply. All these developments would complement the contributions of MFIs. Lack of savings is thus a key factor in the disappointing results of microfinance initiatives in Nepal.

b) Wide Topographical range:

The topography of Nepal ranges from the highest mountain in the world to flat lands that are a few hundred meters above sea level – all within its 200km width. The terai is the bread basket of the country, producing much of the food that the nation consumes. Agriculture in the hilly region is based mainly on subsistence farming. The mountainous region is not suitable for the cultivation of food crops and relies on imported food (Bhatta, G, 2001). While lack of cultivable land is the biggest challenge for the hilly and the mountainous regions, the difficulty of constructing infrastructure also constrains economic development. In particular, the lack of adequate transportation has hindered area development projects. In contrast, projects in the more easily accessible parts of the hilly region and the terai region have met with success. The microfinance program is no exception.

MFIs have not been able to reach the extreme poor in remote areas of Nepal due to lack of proper transportation infrastructure. They are concentrated more in the terai region and other easily accessible parts of hilly region. People in the rural areas have access to 30 percent of the total roads compared to those in the terai region that have access to 60 percent of roads (Development Project Service Center and Ledgerwood, J, 1997). The implementation of microfinance programs has been a function of the accessibility of the target population. Unfortunately, the majority of the target population lives in areas that are not easily accessible- 85% of the population of Nepal lives in rural areas (ARCM, 2007).

Recommendations

Microcredit organizations should work jointly with banks in providing banking services to microcredit borrowers. Importantly, borrowers should be provided access to savings services so that they can reinvest and grow instead of losing their earnings. If MFIs themselves provide savings services, their lending capacity will also increase as the savings of borrowers can be utilized for lending. Also, complimentary policies like building infrastructures should be implemented along with providing loans to the poor.

At present, 3 percent of total loan outstanding of commercial banks in Nepal are invested or used in providing wholesale loans to deprived sectors such as MFIs (Center for Microfinance, 2007). The government should impose laws to mandate more than 3 percent investment by banks on MFIs. This will give MFIs more opportunities and flexibility to expand their outreach and services. Also, it is very important for microcredit organizations to implement different models that are catered to the needs of people from mountain, hill and terai regions of Nepal. Since these regions differ not just in geography, but also in cultural aspects, region-specific strategies for lending would mean better results for the MFIs in the long run.

Another area where MFIs can improve is their targeting of specific groups of people. Incentives in the form of free training and subsidized interest rates should be provided to recent high school graduates who cannot go on to college for various reasons. Reaching out to people at such early stages of their career can prove more effective in the long run than waiting until they have children and families to support.

3.2. Gender Gap

Women in Nepal constitute of approximately 52 percent of the total population (Bhatta, G, 2001) and suffer from discrimination that is weaved into the cultural and social framework of the country. A bill was passed by the Parliament to make the 11th amendment to end the existing discrimination against women by giving women equal right as men on their parental properties before marriage (Singh, J, 2002). Besides this, abortion has been legalized in Nepal (Dahal, K, 2004). This was an important step in giving women the freedom to make their own decision about their life and future, and to help them overcome long-held discriminatory social norms. However, the condition of the majority of Nepalese women is still far from satisfactory. For instance, the female literacy rate is still appalling - more than two- thirds of women in Nepal are illiterate (Singh, J, 2002). To this date, women are discriminated against and lag far behind in many areas including education, healthcare, career opportunities, etc.

One of the main consequences of the gender gap for microcredit programs is the lack of participation of women. In most villages, women are tied to their household duties of cleaning, fetching water, taking care of children, collecting firewood, and thus do not have easy access to microcredit. Even worse, in an orthodox society like that of rural Nepal, women can often only do what their husbands permit them to.

Various studies have now established that microcredit programs do have the potential for women empowerment (Cheston, S and Kuhn, L, 2007). Indeed, one of the main goals of microfinance programs around the globe is to empower poor women. In the case of Nepal, the problem of women empowerment and microcredit programs is however a circular one: while microcredit programs seek to empower women by providing them with loans for independent ventures, the very problem of discrimination against women prevents these programs from reaching those women who need help the most. As an example of empowerment of a woman by microcredit programs, here's the case study of Mrs. Saraswati Khadka:

> Saraswati lives in Sarlahi district in the eastern terai of Nepal. She started a small bee-keeping business with the help of a microcredit program. Before, she was a housewife and a mother of three children of age two, three and five. Due to extreme poverty and unreliable income from her alcoholic husband, she could not feed her children more than once a day and often could not afford sufficient food for herself. She said that her husband would beat her almost every night, sell all her jewelry and whatever he could find in the house, and sell the items to buy alcohol. Saraswati said, "I wouldn't blame my husband solely even though he is an alcoholic. He has gone through a lot in life. He tried all he could for a long time to get employed and to earn decent money. But it was his bad fate that he could not make it and in turn he got trapped in debt and at last got discouraged." However, unlike her husband, Saraswati has succeeded. Today her business exceeds 15,000 rupees (>$200). She started with a loan of 500 rupees (<$10) and, in two years, her business has made significant profits. Today, Saraswati's business is not only famous in her village but is also famous in neighboring villages. She indicated that her husband has stopped drinking and helps her in her business. She feels respected by him and other villagers. Both of them work hard together to provide their children with education and food. Saraswati is now economically empowered and well informed about health, educational and women's rights issues. However, such successful stories of microcredit programs in Nepal are not yet common, and the majority of women still live a life of struggle and hardship.

How empowering women can help

According to the World Bank, societies that discriminate based on gender have greater poverty, slower economic growth, weaker governance and a lower standard of living (Cheston, S and Kuhn, L, 2007). Women are at the frontline of every household in Nepal and most third world countries. Without progress of women, progress of the society or nation as a whole is considerably more difficult, if not impossible. Microcredit programs, if implemented correctly, have the potential to reduce gender gap and empower women in such societies. A survey of 60 microfinance institutions and Opportunity International's 42 partners along with Sinapi Aba Trust (SAT) found strong evidence that microfinance institutions contribute to women's empowerment (Cheston, S and Kuhn, L, 2007). Moreover, women's empowerment is believed to be the very basis of economic empowerment of a nation (Chadha, S, 2006).

Urban centers like Kathmandu are good examples of how MFIs can help women.

The vibes of women empowerment have become stronger and more noticeable in the Kathmandu valley recently. Innumerable women from rural areas have migrated in to start their own business. I observed that the number of street vendors have increased significantly. In many cases, these businesses are operated by women or jointly by husband and wife. Women have even started driving public transportation vans (called *safa tempos*) purchased with the help of microcredits. This is a significant achievement given the cultural norms of Nepalese society, which make people believe that driving is a male occupation. It is hard not to notice the growth of small family-run businesses like these in Nepal, and this was confirmed by my interviews with the street vendors in Kathmandu. Many women reported being more independent and respected because of their success in small-business ventures.

What needs to be realized, however, is that while MFIs can lead to women empowerment, successful implementation is dependent on certain women's freedoms and rights. In other words, a certain level of empowerment of women is a prerequisite for successful MFI's. Many women in rural Nepal lack freedom, respect and independence. Ideally, one would start complementary projects to decrease the existing gender gap when implementing microcredit projects. Such projects, while not absent, have rarely been combined with microfinance initiatives.

Microfinance projects in rural areas may be very different from those in the Kathmandu valley because of the gender gap. The main problem for microfinance in empowering women and reducing poverty appears to be reaching out to poor women in rural areas. Even in cases where programs have tried to focus on providing loans to women, policies have been such that men benefit more than women from MFIs.

According to a study, larger individual loans tend to be available more often to men than women (Chadha, S, 2006). Moreover, research found that 90 percent of borrowers in the deprived sector were men for a poverty lending program whose target was “production credit” to rural women (Rankin, NK, 2001). This clearly reflects the existence of gender discrimination in Nepal and, worse, that MFIs have not been able to address it.

The microcredit Summit Campaign reports that 14.2 million of the world’s poorest women now have access to financial services. However, in the case of Nepal, the majority of women still work 10 to12 hours in the household compared to 7.5 hours for men, and the literacy rate for women is 35% compared to 63% for men (Chadha, S, 2006). Even if women get financial assistance from microcredit programs, it is less likely that these women will start a business that will benefit them in the long term. Therefore, simply providing financial assistance to these women is not enough to empower them. Complementary steps to help them take advantage of the opportunities provided by MFIs are equally important. MFIs should work alongside INGOs that seek to decrease the gender gap in Nepal.

Recommendations:

The most important step is that the current strategy of solely providing loans has to be modified. A packaged program of training and educating women and men should supplement loans. Such training will educate and train the poor and uneducated borrowers, allowing them to make safer and more profitable investments. Moreover, since a variety of sectors suffer from the ongoing political conflicts in Nepal, programs focusing mainly on healthcare, education and agriculture, as opposed to trade and transportation, for instance, should be implemented in the package. This will help women do their job without worrying too much about political problems and gives them the career stability they need to make the best use of their loans.

Another idea is to try to target young women right after their marriage. Extended repayment period, lower interest rates or other extra facilities should be provided as incentives to those women so that they can be independent right from the beginning of their relationship with their husbands and in-laws. Such practices can go a long way—not only will the newly married couple get a head start on the road to financial stability, but lack of reliance on the husband’s income will give them the independence they need.

A group of women is more powerful than a single woman. Microcredit programs can be more effective if group lending strategies are implemented. This way, women can cooperate and work towards a common goal instead of competing against each other. Group lending also allows women to solve problems in their businesses much better, which will in turn increase the likelihood of microcredits being successfully utilized.

3.3 Unfavorable Small Business Climate

The “People’s War” was started in 1996 by the Maoists of Nepal (Chowdhury, QA, 2001). Ending the system of absolute monarchy and establishing the People’s Republic were two major goals of this movement. Initially, the war started on behalf of the majority of rural poor of Nepal to free the country of a feudal system (Chowdhrury, QA, 2001). However, in the last decade, the Maoist war took a different mode, giving rise to conflicts, terror, insurgency and insecurity.

The conflicts and insurgencies brought in by the never ending civil war have affected more than sixty out of seventy five districts of Nepal, exceeding more than 8,000 deaths by the year 2003 (BBC, 2003). This has in turn affected the transportation system, schools, trade, and tourism, triggering inflation, a high unemployment rate of 42 percent and significant political instability. Nepal can now be said to be going through a "twin crisis" of both political and economical insecurity, which has ruined the lives of thousands of people around the country. Tourism is one of the major income generating businesses of Nepal and comprises of about 4% of total gross domestic product, 15% of the foreign earning and 27% of total merchandise export (Kharel, KG). Tourist arrival dropped by approximately 40 percent in 2005 (HASATR, 2005).

A decade long civil war in Nepal has thus created unfavorable climate for small businesses. Borrowers of microcredits who invest in small businesses have been at a tremendous disadvantage ever since the Maoist insurgency started. This is a major challenge for many microcredit organizations, especially those whose clients reside in remote areas of Nepal. Even in big cities, small businesses face the threat of constant stikes and "bandhs" (a ban on transportation, office work, and businesses).

> I interviewed Mr. Naresh Simkhada in January 2007. His case is a clear example of a borrower of a microcredit program devastated by the unfavorable climate for small business in Nepal. Naresh was originally from a hilly region of Nepal and lived with his small family of five. He came to Kathmadu in 2002 with a very small amount of loan he had received from a microcredit organization located close to his village. He wanted to invest the loan in something profitable this time. Naresh had received loans from other organizations in the past, but due to economic hardship, he was not able to invest a significant portion of the loan in business. Naresh traveled all the way to Kathmandu this time and bought a rickshaw (a three wheeled cycle used to carry people around). His business went well at the beginning, as there were a lot of tourists around. Naresh had started saving a reasonable amount everyday in the first few months. However, his business slowed down as the security situation deteriorated and there was a drop in the number of tourists visiting Nepal. Due to frequent strikes and "chakka jams" (ban on usage of all kinds of vehicles), Naresh's business is in a terrible shape these days. He now earns about $2 per day, which is no better than how it was before he started his rickshaw business. According to Naresh, this is happening to many of his friends, even people who are not in the transportation business.

Recommendations

The Nepalese government can help small business entrepreneurs by cutting taxes imposed on exports of goods from businesses and areas funded by microcredit organizations. This will give potential borrowers the confidence to borrow loans and invest in small businesses in the face of unstable political and economic conditions in the country.

Another way of increasing incentives for borrowing and investing is providing subsidized interest rates and extended repayment time so that borrowers are not pressured to do exceedingly well in their businesses. This will also give the borrowers the flexibility they need to keep their businesses running through political strikes and economic droughts. In addition, innovative business consulting and education should be given to the poor and uneducated borrowers so that they can make better business decisions. This kind of service can be especially helpful in the current political and economic climate of Nepal where entrepreneurs either need innovative ways of doing businesses, or need to better assess the feasibility of different enterprises both in urban and rural areas.

4. Summary

The population of Nepal living below the poverty line went from 42% to 31% between FY95/96 and FY03/04 (The World Bank, 2007). This reduction in poverty is possibly due to factors like increase in remittance earning in the past decade. The contribution of microcredit programs to the observed poverty reduction is however questionable. Although the concept of micro-lending was introduced in Nepal more than two decades ago, the number of poor people, especially poor women, reached by microcredit programs is far from satisfactory. In this paper, I have identified three major challenges faced by microcredit programs in Nepal- extreme poverty, wide gender gap and unfavorable climate for small businesses - that might have contributed to their relatively poor performance. Overcoming these challenges require restructuring of strategies and policies of MFIs. In many cases, simply providing loans is not enough. Loans should be supplemented by training and consulting services so that borrowers can invest money at the right time and place. Moreover, such services should not end with loan disbursement. Borrowers should be supported at all points of their business venture. New strategies should be devised to give potential borrowers the confidence to use loans to run new businesses in the face of an unstable economy and political system. More importantly, lending policies should be catered to the needs and problems of specific demographics and geographic areas of Nepal. These changes are crucial for reaching and helping the poor in rural areas and the women who have suffered discrimination and o

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