Governor Dr. Yuba Raj Khatiwada's Remarks

Seminar on Microfinance & Social Business

Organized by: Rural Microfinance Development Centre (RMDC) Ltd.
December 21-2012, Kathmandu, Nepal

Chair of the seminar on Microfinance and Social Business
Right Honorable Prime Minister
Guest of honor Professor Muhammad Yunus, the Noble Laureate,
Vice Chairperson of National Planning Commission,
Distinguished guests & participants

1. Thanks to the organizers for giving me the opportunity to address this august gathering in the presence of the Right Honorable Prime Minister and Noble Laureate Prof. Yunus. Today, I want to listen more than to speak because the towering leader of the microfinance and the persons of the highest stature in rural banking and rural microfinance are among us. Let me just put a few observations on how Nepal has progressed on microfinance services and what the challenges are.

2. Let me first start with the achievements. There has been great expansion of the financial services for the last several years. So far, at least about one and a half million people have been mobilized by microfinance institutions. Of course, there may be the cases of duplication but we can safely say that a large section of the poor households (estimated to be 1.4 million) have already been mobilized by microfinance and they have been instrumental to reduce absolute poverty, empower women, and uplift living standard along with encouraging an inclusive economic growth.

3. During the last fifteen years or so, Nepal has also been able to reduce poverty, more than one percentage point every year which is mainly attributed to the expansion of microfinance and the inward remittances from our migrant workers abroad. Thus despite the fact that the economic growth has been very moderate and that we have not been able to implement sufficient poverty reduction programs, still absolute poverty has come down. And, we have attributed this result to the success of microfinance along with other community and social sector interventions.

4. But let me also cite that Nepalese still have a limited outreach to formal financial services. Only a quarter of the household have access to formal banking financial services. Some more are served by saving and credit cooperatives and financial NGOs. So far as the microfinance institutions are concerned, they are only providing micro credit. Still more than 50 percent borrowing households resort to informal financing sources which could be relatives, family & friends, and local landlords or local merchants.

5. Also we have not been able to reach the hardcore poor and also to the areas which are remote - in terms of physical infrastructure. So the issue of inclusive finance is very much pertinent and the real challenge is on expanding our services to the underserved areas with credible models, frameworks, and instruments of microfinance.

6. There are several challenges to microfinance in the country. At the moment, resource is obviously a challenge. At present the deprived sector lending requirement of the financial institutions as directed by the NRB provides captive source of fund for the microfinance institutions. As per the directive, commercial banks have to lend at present 4 percent of their total loan portfolio to the deprived sector, gradually leading to 5 percent in a couple of years' time. Development banks and finance companies are also required to allocate 3.5 percent and 3 percent of their credit respectively to deprived sector, which in turn provides resources for the microfinance institutions for on-lending to the poor. But there is a limit to such a captive resource to the microfinance institutions and we cannot keep on increasing the proportion forever.

7. There is also donor support to some of the microfinance activities and it is not necessary that their support continues for long. So the microfinance institutions have to resort to their own resources on a sustainable basis.This is possible by mobilizing local savings.Then obviously the question comes that: should they be allowed to mobilize saving outside the membership or the groups in the form of deposit? When microfinance institutions have to mobilize deposits outside the group, perhaps they have to follow central bank's regulations which might be stringent for the microfinance industry as a whole. Besides the

low capital base of the microfinance institutions and deposit collection facility may not be a comparable thing. So it is a debated issue whether we should be providing microfinance institutions with proper deposit mobilization facilities, although Nepal Rastra Bank has already provided this facility to some of the microfinance institutions operating in the areas where there are no commercial banks and other financial institutions.

8. The other issue is related to the lending rates. There is a complaint that lending rates are exorbitant – that the margin between the cost of fund and lending rate is too high and that some of the poor borrowers have difficulty to borrow at such a high rate. This issue must be addressed if we want to see microfinance institutions distinct from local money lenders. Of course, microfinance loans being of short term nature, could still work for most of the lending programs. But if it is of medium term nature or let us say of more than one year in the future reframed financial model, perhaps the high interest rate structure does not work. And to compensate or to complement the cost of operation of the microfinance institutions, there must be a mechanism of cost sharing of the operation of the microfinance institutions–this may be in terms of infrastructure, in terms of IT or in terms of other facilities including the activities related to social mobilization, literacy, health insurance, and community development like that of Poverty Alleviation Fund. Only then we can perhaps minimize the operating expenses of the microfinance institutions and then perhaps moderate the lending rates.

9. There are several other issues like that of duplication and multiple banking and there has been a tendency of grabbing the client or the member mobilized by other microfinance institutions into ones' business. That cannot be said to be a good idea and it only escalates unhealthy practice in the micro finance industry. Sometimes, people already mobilized by other agencies are given loans by new coming or other institutions which is again unhealthy competition. Also borrowers are often over lent or they have been overbanked and they have unsustainable debt with them. Collecting credit information and sharing

the information among microfinance institutions would be a very important intervention in this regard.

10. The other issue is profitability. Of course, Professor Yunus advocates social business and it is a Nobel idea. While doing social business one must have profit but the profit must be ploughed back to the same business and no drawing down of any dividend.Of course, microfinance institutions are doing a kind of social business, but they are also getting lot of profits out of their operation. This profit is being questioned in the context of social business and also in the context of claim of social contribution made by those institutions. So much so that some of the microfinance institutions declare their dividend to the extent of one third of their capital. Such a big profit is luring more microfinance companies to come into that business, which is not a healthy thing when we have so many institutions already in operations.

11. So while, I urge our microfinance institutions also to come into social business, we don't at the moment stop these institutions from drawing down some of the profits as dividend but we want to say that our microfinance institutions must be happy with normal profit and should be able to share their excess profit to their borrower and also to their other stakeholders including the savers. This could be done through a better pricing of their services. Only then microfinance would be growing with a social face. Otherwise it would be like any other financial business without much of the human face. So the basic idea is to give the message: let's grow together (institutions as well as borrowers). Microfinance institutions must grow together with their clients and they need to see if they have really uplifted the living standard of the people/client they have been engaged with. It is not only the profitability of microfinance but also the well-being of the borrowers who can tell the success story of the microfinance business.

12. Let us also think about finding innovative models of microfinance not simply replicating or adopting but adapting the same to suit country condition. The Grameen model does not work when there is no market, when there is no infrastructure, or when there is no dense population. Unlike in Bangladesh where you have this facility, where you can ride a bicycle to reach your client, where borrowers can have group meeting

very frequently, and where you have the market place to exchange your products with money to repay the bank loan, Nepal has places not having the same pre-conditions for the expansion of microfinance. So we need to change the modality and frequency of group meetings, loan repayment and monitoring. Particularly, we need to have different modalities of services including a longer period of repayment or less frequent group meetings and some other modality. We really need to think about how microfinance institutions could be supported by government and non-government mechanism. Here, I would like to seek Professor Yunus' brilliant idea on what should be the model that could better work in the context of Nepal where we don't have better infrastructure or where we have very sparsely distributed population.

13. We also have to coordinate our activities with other intervention in poverty reduction as we need to understand that poverty is a multidimensional issue and microfinance only cannot resolve all the dimensions of poverty. So coordination between government agencies, NGOs and community organizations would be important to carry on poverty reduction agenda along with microfinance. And, we should never forget our social responsibility while doing the microfinance business - it must be 'cause driven' rather than 'profit driven'.

14. In concluding, I would say that let us not overly burden microfinance institutions for poverty reduction. They must be doing their job but let us also complement them with other interventions which could together help to reduce poverty. And of course, let us also widen and deepen other components of microfinance without which investment in microenterprises like agriculture, livestock, fisheries or other risky ventures would not succeed. Let us also have the mechanism like micro insurance which helps in managing the risks of micro enterprises. As such, insurance must be an integral part of microfinance and insurance companies need to do their business in their area.

Thank you very much.