

STRENGTHS AND POTENTIALS OF INFORMAL SELF-HELP FINANCIAL SYSTEMS IN NEPAL

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1. Background

The importance of rural credit for transforming the rural economies of developing countries has gained wide acceptance. In a country like Nepal where about three-fourths of rural families are small and marginal farmers, who frequently confront shortages of financial resources to explore farm and off-farm sector production potentialities, the significance of rural credit is, indeed, very high.

Since the mid-Seventies the HMG/N has been launching specialized credit programs such as Small Farmers Development Program, Intensive Banking Program (including Production Credit for Rural Women) and Cottage and Small Industries Project aimed at meeting credit needs of the rural poor and marginal families. The Cooperative scheme initiated in the early sixties, and the recent Grameen Banking Program, Nirdhan and other NGOs/INGO – driven credit schemes also aim at enhancing access of credit to the rural poor.

Despite the prevalence of formal credit system focused on rural poor for over two decades, there has now been a realization that: (i) it could not reach a large fraction of the rural poor; (ii) it is not cost-effective to small borrowers; and (iii) it supports the affluent members of the rural society and (iv) it transfers resources from the State to the already better-off people. Hence, the poor are bound to gain access to credit from informal sources.

The informal rural credit systems are operated in individual and group forms. Farmers' associations and pre-cooperatives and cooperatives are the forms of group-based informal (self-help) financial system established (as savings and credit schemes) by the homogeneous economic/interest groups to meet their credit needs by mobilizing local resources.

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Currently, Nepal is pursuing liberal financial policies. The role of the government in rural finance has come increasingly under scrutiny. But the importance of informal (self-help) financial system has not been given due attention by the State as no information has been collected yet on their role and significance.

Recently, the author conducted a study entitled "Informal (Self-Help) Financial Systems in Rural Nepal: The Case of Rupandehi, Nawalparasi, Palpa and Kaski Districts". The main objective of the study was to identify the existence, operational characteristics, strength and future potentiality of the systems to mobilize local resources and meet the credit needs of the rural poor. The study has identified some promising features of the systems including their underlying causes, which are summarized here.

2. Definition

The study defines informal (self-help) financial systems as those rural institutions which are created through the local peoples' initiatives and where the resources mobilized by the institutions come from local sources and the benefits go to those people who contribute to establish the associations. In other words, the systems were identified based on their two key features: (i) whether or not they were established through local initiatives and mobilized local financial resources/management skill; and (ii) whether or not there was autonomy in management, decision making, policy design, and in executing savings and credit activities.

3. Establishment and Features

There were 32 systems (10, 9, 9 and 4 respectively in Rupandehi, Nawalparasi, Palpa and Kaski), in the study districts which met the above criteria. The study had identified and enumerated all the systems.

Floating of shares, shareholders' (members') monthly contribution (savings), and interest earning from borrowers are the principal sources of fund accumulation for lending purpose. Their savings and credit operations are, therefore, being operated purely on a self-help basis. However, some of the institutions have obtained resources from other sources also, particularly after their lending operations were started.

All the systems were new, established during 1989 - 1994. NGO and self-help initiative had initiated their establishment. Eighteen systems had been registered with the

District Cooperative Office under the Cooperative Act 1992. None of the systems had started lending activities after registration and without preparing by-laws and operational plans.

The associations were established either after some members' bitter experience with bank(s) or with objective of obtaining consumption/incidental loan which are very frequently required in low income households but not available from banks. The key objectives of all the systems were: (i) to promote saving habit of low income people; (ii) to emancipate them from usury; (iii) to increase access of credit to meet their incidental expenses; (iii) to increase poor peoples' production potentialities; and (iv) to help create independent but cohesive rural societies.

4. Key Findings

Currently, the systems have a total membership of 2,845 people (123 on average) distributed in 20 VDCs and some clusters of 3 Municipalities (2 to 3 wards) of the study districts.

The institutions provide average interest rate at 15 per cent to savers and charge 19.2 per cent average interest to borrowers. By the end of 1994 the systems have collected a total amount of Rs. 12.52 million and disbursed Rs. 16.66 million. It is estimated that 75 percent of the shareholders' total credit needs have been met by the systems todate.

The institutions have been providing credit for consumption or incidental and production purposes. The former is taken for buying food-stuff and clothes, celebrating festive occasions, and incurring incidental expenses, and the latter for crop and vegetable/horticulture farming and livestock raising, and to install small-scale cottage industries, tea stalls, restaurants, small-scale retail shops, medical halls and to purchase transportation equipments such as rickshaw, auto-rickshaw and tyre-carts.

The most encouraging aspect of the informal institutional loan was its repayment performance (100 percent). The reasons identified were: (a) there was no misuse of loan because there was provision for many types of credit; (b) all the members had group discipline and feeling of ownership toward the institutions; and (c) the institutions frequently disseminated information among the shareholders on credit performance of the borrowers and resources at their disposal.

The average institutional cost of the systems was calculated at Rs. 3,324 per annum. The main reasons were: (a) most of the institutions had recruited one of their shareholders

and his/her time spent on the institution was compensated; and (b) the offices were kept in an executive member's house or in a community building or in one or two rented rooms or their own buildings. **The local voluntary support and simplicity of credit procedure have been the central reasons for the low overhead cost in the informal systems.**

Credits are issued against person and/or land ownership certificate as loan guarantee. The credit is approved by evaluating loan applications on the basis of (a) purpose of credit; (b) size of credit demanded; (c) applicant's past credit performance; (d) current liquidity at the institution; (e) agreement of guarantor(s) to guarantee the credit (on person-guaranteed loan); and (f) feasibility of the scheme (On production loans).

The executive members hold responsibility of credit follow-up and recollection. But they do not spend much time in these activities because (a) the borrowers themselves repay on time; (b) the prospective borrowers remain vigilant for timely repayment of credits; and (c) delay in repayment enlists the borrowers in blacklist for the future.

All the positive and encouraging aspects found with the systems are related with peoples' sincere participation and growing enthusiasm to make the rural society self-sustaining. The existing formal credit systems and other local initiatives could take benefit from the causes of the strength/success stories of the informal self-help systems to make their efforts more objective-oriented.

5. Strength

Local Resources Mobilization: The study reveals that if local people are organized themselves, and pooled to manage their resources in a proper way they won't confront resource shortages. Such savings and credit institutions can also serve as a key mechanism to associate socio-economically like-minded people by themselves, create cohesive rural societies, and lead the rural societies towards self-sufficiency through local resources mobilization.

Cost-Effectiveness: Another strength of the informal financial systems is reflected from the low cost of credit both to the lending institutions and the borrowers. The shareholders' voluntary contribution in assessing credit feasibility (before lending) and in conducting credit follow-up have made the lending cost minimum. The interest rate to borrowers is much lower than from the money-lenders and there is no indirect cost of borrowing.

Credit Recovery: All the systems studied have achieved a commendable credit recovery performance. The notion of self-help among the borrowing and non-borrowing shareholders and their ownership feeling towards the systems have been the principal reasons for the borrowers' motivation to repay credit on time.

6. Policy Environment

The government is pursuing liberal economic policies which do not at least constrain establishment and promotion of the local self-help initiatives. The Cooperative Act 1992 is worth mentioning here. Firstly, the Act provides simplified framework to form farmers' association/self-help initiatives. Secondly, the institutions which grow fast and need protection can take help of the act which could preserve the notion of self-help in the institutions and safeguard interest of needy shareholders.

7. Scope for Expansion

In the study districts the number of the informal financial systems and their activities have expanded over the years. The credit needs met by the institutions and their inherent strength have inspired many poor people and backward communities to associate themselves, and establish such savings and credit associations. If the current expansion trend continues, the study believes that there will be many similar systems, even in the remotest parts of the study districts by the turn of the decade. As mentioned in the study report, such systems have reduced the importance of banks particularly for credit purpose in some parts of the two studied districts Rupandehi and Nawalparasi.

"The groups formed through the government line agencies have accumulated a substantial amount of group funds but yet to be utilised. Likewise, all registered dairy cooperatives are planning to utilize the accumulated resources for lending to their members. Besides, many savings and credit associations are in the process of establishment". If it is so, there is a strong scope for such informal financial systems' expansion in the near future.

8 Conclusion and Recommendations

A. Conclusions

To summarise, the existence of full autonomy in the institutions' management and savings and credit operations has been the key ingredient for success of the systems in serving the interest of the resource scarce people. The solidarity and self-help feelings

among the shareholders and their accountability towards the institutions have been other important factors for speedy progress in local resources mobilization and in meeting various types of credit needs. The low institutional cost and excellent credit recovery performance show the future viability of the systems both to the lending institutions and the borrowers. Such self-help systems could also further serve as a strong mechanism to associate the like-minded rural mass a pre-condition for rural development and sustainable poverty alleviation.

The informal systems have very limited functional link with the formal systems and government agencies. To keep these systems working and meet their objectives these institutions should remain autonomous. It can be learnt from the study that if the rural poor are organized and resources pooled, a substantial amount of money can be gathered within a short period of time. Hence, availability of fund does not seem to act as constraint in the rural societies (because fund can be raised there) the important matter is to organize or associate the like-minded rural people and utilize the collected resources in a proper way that ensures benefits to the participants.

B. Recommendation

On the basis of the study findings some recommendations have been made which might be helpful in promoting and strengthening the informal financial systems in the rural communities. The recommendations are made in two levels: (i) for the informal financial institutions at the local level; and (ii) for the policy designers at the centre.

Informal Financial Institutions

- (a) Some of the informal financial systems are expanding in such a way that their volume of activities are moving parallel to the state financed credit programs. These institutions have to know how much the talked about formal credit programs have lost their credence because of their unplanned expansion. Some of the informal institutions already have a very high number of shareholders and credit operations. And there is an ongoing social pressure to increase the number of shareholders. If the number of shareholders is increased randomly the management problem may appear in the institutions. This may result in poor performance of the systems, gradual decline of their self-help feature and shrinkage of shareholders' ownership feeling and accountability towards the institutions. Therefore, instead of membership expansion, such institutions should encourage the interested people to form other similar self-help groups and mobilize resources among themselves.

- (b) In Nepal, past experience shows that when a local initiative performs satisfactorily the donors/INGOs show their interest in supporting it. Once there is an inflow of financial resource the system wants to build relations with multiple donors, and perception develops that the more donors are in contact with it, the more successful the system is. Usually, the outside interventions do not come alone but come with conditionalities. When a system is provided with fund support its original self-help feature is greatly distorted because the shareholders gradually lose their ownership feeling toward the institution. Besides, the conditionalities set by the donors are generally inconsistent with the institution's original functional characteristics. In such a situation, the local initiatives remain neither in the form of self-help nor informal. Since the institutions are not short of resources to satisfy their members' credit needs they should try to remain away from outside support as far as possible.
- (c) In all the institutions the quality of record keeping is not satisfactory. The sub-accountant and selected executive members should undergo short-term office management training, if possible, observation visits within and outside the country. This will enhance the institution's efficiency and help identify innovative schemes with a limited investment in manpower development.
- (d) Sooner or later, the provision for group loan would be a must for all the institutions. Investment in innovative and labour intensive schemes would be possible only when large credits are made available to the borrowers. This would only be possible through group loan provision. For example, some of the institutions have set their long-term goal to establish medium-scale labour intensive industries in the respective localities. Similarly, the savings and credit systems transferred from the dairy cooperatives have shown their interest to establish cattle-feed industries. Investment in such schemes is not possible from small scale individual loan but it demands bigger size of credit. Such investments could serve as important instruments to benefit the resource short rural mass.
- (e) Some of the institutions have already accumulated a substantial amount of funds at their disposal. They are thinking of operating rural cooperative bank by providing loan to non-members also. This idea cannot be rejected for the long-run but, at their current stage, they are not advised to do so. The operation of banking activities is possible only when all the required infrastructures are at hand. So, the informal financial systems are not advised to operate banking activities at their prevailing stages.

- (f) The informal rural savings and credit institutions are planning to federate at the district level. This is an encouraging and innovative step towards the systems' promotion and would help safeguard the poor and low income peoples' resource and interest. It should be executed soon.

Policy Designers

- (a) This study findings show that the number of savings and credit institutions is on the increase every year in the rural areas of the study districts. Apart from the existing institutions a large number of groups formed by the sectoral government line agencies (to implement their regular programs) have accumulated a substantial amount of group funds. They are planning to mobilize accumulated resources for the benefit of the savers. The success stories of the self-help financial system have inspired them to operate lending activities. So is the case with the existing dairy cooperatives. The milk producers have saved a significant amount of financial resource as group savings through their own efforts. Both sectoral groups and dairy cooperatives are preparing their by-laws to start lending activities to their share holders (in fact some of the dairy cooperatives have already started lending to their members). The absence of the government's regulatory policies have largely contributed in the promotion of the number and activities of such local (self-help) initiatives. Therefore, no additional policies seem to be required other than timely introduction of Rules of the Cooperative Act 1992.
- (b) The state could provide or arrange for non-financial supports if it really wants promotion of such informal financial systems in the future. The supports could be provided by (i) arranging institution management and accounts-keeping training to the executive committee members and sub-accountants; (ii) helping to build link with the government's sectoral line agencies to acquire services from their regular programs (like agriculture, livestock and cottage industry related training and observation visits, and marketing of output); (iii) disseminating information on the underlying causes for success of the informal financial systems; and (iv) identifying potential, innovative and labour intensive schemes that increase income of the systems' poor and low income shareholders. The domination of consumption and incidental loans in all the systems indicates that there is a huge deficit financing at the household (society) level, and local financial resource is mobilized mainly for unproductive use. To improve the situation, including consumption/incidental purpose, the system should concentrate lending towards labor-intensive high-return innovative schemes.