Functional and Conceptual Differences of Micro-credit and Micro-finance in Nepal

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Abstract

The study analyzes the functional and conceptual differences between micro-credit and micro-finance in Nepal. The main concern of this paper is to analyze the fundamental differences between the concept of microcredit and microfinance. Generally, it uses similar terminology; however, it has certain fundamental dissimilarity on a practical level. The main focus of this study is to analyze theoretically and conceptually differences the terms used in the field of economic development and poverty alleviation field. The study has been based on a qualitative research paradigm and only secondary sources of data were used for this study. Books, articles, thesis, dissertations, and reports were the main secondary source of data. Secondary information has collected through the library research method. Data were analyzed by using a simple paragraph description. The conclusion of this study has been drawn based on analysis and description.

Keywords: concept, function, micro-finance, micro-credit, Nepal.

Introduction

Microfinance is a development tool that grants or provides financial services and products such as very small loans, savings, micro leasing, micro-insurance, and money transfer to assist the very or exceptionally poor in expanding or establishing their businesses**.** Now it has become a buzz-word among the development practitioners. In the process, the word has been imputed to mean everything to everybody.' It now seems obvious that there are serious disagreements among micro-credit practitioners and policymakers about the role of small-loan programs in efforts to alleviate poverty. Microfinance institutions provide an alternative source of credit on the subsidized interest rate for the rural people having no collateral, unlike moneylenders who charge exceptionally high-interest rates. Microfinance institutions usually target small-scale businesses in the rural and agricultural sectors (Sanyal, 2009, p. 529). It provides people with a chance to work and earn money by enhancing their capacity to provide for themselves."Access to credit is a useful and quick way for the poor to have the means to pay for food and shelter. Poor persons often lack the necessities of life, such as food, shelter, education and healthcare "(Hudon, 2009, p. 19). To help improve the social and economic conditions of the former colonies, national and international agencies were created to transfer Western funds and materials (Harcourt 1997). This policy is popularly known as the 'top-down' approach to development because the governments that received aid and loans were primarily responsible for how they were used. Unfortunately, these international aid programs were largely unsuccessful. The failures attributed to the lack of participation by the intended beneficiaries of development projects the process of designing, formulating, and implementing these projects (Rehnema 1992; Waddimba 1979; Wolfe 1981). Thus, the 'top-down' approach was gradually substituted by the still popular 'bottom-up' approach, which views participation and participatory methods of interaction as essential dimensions of development. The World Bank endorsed the idea in1973 when Robert MacNamara (1973) told his audience that no program would help small farmers if it was designed by people who did not know about the farmers' problems, and implemented by those who had little interests in their future. Eventually, the 'bottom-up' approach, or 'participation and participatory methods', began to dominate policies of bilateral and multilateral agencies (Stigliz, 1999; Wolfensohn, 1999).

History of microfinance in Nepal

In the context of Nepalese economics, it has been found used in Nepal only in the latter part of the 1990s. Although rustic credit in Nepal began in 1956 with the opening of Credit cooperatives in Chitwan Valley to provide loans to the re-settlers coming from different parts of the country (Shrestha, 2009, p. 11). Shrestha(2009) further writes about the initiation of microcredit as:

The government through the formation of the Cooperative Development Fund (CDF) settled some credit support to the re-settlers through those cooperatives. In 1963, the government established the Cooperative Bank, which was later converted into the Agricultural Development Bank, Nepal (ADBN) in 1968. The Cooperatives faced problems of shortage of funds for credit payment to their members on the one hand and fraud of borrowed funds for personal uses by some of their officials on the other. Hence, the government hired a fact-finding mission in 1968 to probe the operations of 1489 cooperatives then registered with the Department of Cooperatives and the mission found most of them at the defunct stage and recommended for their insolvency. Thereafter, the government introduced the Cooperative Revitalization Program in 1971. It ratified the Agricultural Development Bank Nepal to run cooperatives under its control and management (Shrestha, 2009, p. 11)

It was 1976 when the 'Sajha Program' was launched and the Cooperatives were renamed as 'Sajha Societies'. The compulsory reserves collected under the Land Reform Program of 1964 (2021 B.S) were converted into the share capital of the Sajha Societies. The NRB conducted a yardstick survey in 1983/84 to assess the situation of the cooperatives. National Cooperative Development Board (NCDB) constituted of 11 members to provide policy directives to the cooperatives. The government-endorsed a new Cooperative Act in 1992 to ease the promotion and development of cooperatives as a vehicle of economic development in the pastoral areas. The government also underscored the role of cooperatives for outspreading credit facilities and other services to the rural people in its Eight National Plan. Institute of Microfinance (InM). The Nepal Rastra Bank (NRB) initiated Small Sector Lending in 1974 directing the commercial banks (CBs) to invest 5% of their deposit balance in the Small Sector, which was later designated as the "Priority Sector Lending" in 1976. The NRB subsequently initiated the "Intensive Banking Program" (IBP) in 1981 to boost up PSL lending to the low-income group and required CBs to raise PSL to 8% of CBS' loans and advances, which was further raised to 12% in 1989. The main partners of PSL were the Nepal Bank Ltd. (NBL) and the Rastriya Banijya Bank (RBB) - the two state-controlled CBS. The share of NBL and RBB in rural credit supply was 4.1% and 2.4% in the Sixth and 12.3% and 6.7% in the Seventh Plan periods. Loans under PSL were classified into agriculture, cottage productions, and services.

Target groups under PSL are low-income families with Rs.2.511 or less as per capita income per year. The beneficiary must contribute 20% of the project cost if the loan size was more than Rs. 15,000/-. NBL and RB charged 15% to 16% interest rates on priority sector loans. They provided loans up to 80% of the appraised value of the collateral for low income and 70% for high-income families (Shrestha, 2009, p. 12).

Microcredit has a long history in Nepal as well as it has many fluctuations. The policy and apprehensions were on change. Shrestha further clarifies its history as:

However, these CBs provided loans to the group members of Production Credit for Rural Women (PCRW) formed by the Women Development Section (WDS) of the Ministry of Local Development and the groups twisted by the bank staff without collateral on just group guarantee. The loan limit for such loans was Rs. 30,000/-. NGOs, Nirdhan, and the Centre for Self-Help Development (CSD) also were registered under it. Later 47 NGOs got a license from the NRB to operate as FI-NGOs. In 2004, the government announced the Banks and Financial Institutions Ordinance (which was converted into an Act in 2006), (Shrestha, 2009, pp. 13-14)

The government of Nepal introduced the Banks and Financial Institutions Ordinance in 2004 and it was converted into an Act in 2006, which has a provision of licensing microfinance banks also as a class 'D' banks. As a result, 13 microfinance banks have been issued a license by the NRB until the date. To make accessible small wholesale funds to cooperatives and NGOs providing loans to the low-income groups, the government had created a fund called Rural Self-Reliant Fund in 1991 with Rs. 2 corers subsidized by the government. "

Methodology

The study has been based on a qualitative research paradigm and only secondary sources of data were used for this study. Books, articles, thesis, dissertations, and reports were the main secondary source of data. Secondary information has collected through the library research method. Data were analyzed by using a simple paragraph description.

Functional and Conceptual differences of Micro-credit and micro-finance in Nepal:

Micro-credit advocates about the credit as like human rights, and believe that they can inspire social and economic revolution through organizing the poor, under the banner of the Grameen-type micro-credit organizations. Microcredit has been taken as an umbrella term which is a little bit different from microfinance. Micro-finance is defined as a development approach that provides financial as well as social intermediation (Ledgerwood 1999; Robinson 2002). The provision of savings, credit, and insurance services involves it organizing citizens' groups. It includes their aspirations and raises concerns for consideration by policymakers and develop their self-confidence. These services are provided by three types of a lender as, formal institutions, rural banks and co-operatives; semi-formal institutions, such as NGOs; and informal sources such as moneylenders and shopkeepers. Institutional microfinance includes micro-finance services provided by both formal and semi-formal institutions, collectively referred to as Micro-finance Institutions (MFIs) (Asian Development Bank 2004).

The basic functional difference between micro-credit and micro-finance programs concerns the type of service that they provide. The former, such as Grameen, provide mainly one kind of service - loan distribution and recovery - which is linked to group formation and compulsory savings. On the other hand, Micro-finance programs provide all kinds of financial services, including micro-credit. Thus micro-credit is a necessary, but not sufficient, an element of the new financial sector that seeks to cater to the credit needs of the poor who don't have access to formal sources.

This is perhaps the reason why the micro-finance movement is described as the second revolution in credit theory and policy (Woller 2002). The first revolution concerned micro-credit and was focused on overcoming the structural barriers to providing savings and credit services to the poor. These barriers include information asymmetries, lack of collateral, high cost, high risk, and systematic market bias. The key methods used in micro-credit schemes areas; a standardized and limited set of products and services group lending social collateral forced saving small initial loan site loan size tied to saving standardized loan repayment and disbursal schedules frequent repayments.

The promoters of the second revolution describe the primary purpose for organizational satisfaction and donor demands. It not only demands of their customers or clients have also specific on the program. Micro-credit programs provide product-centered services, as they find customers to match the demands of their product (small loans), rather than developing products to match the demands of their customers. Thus the proponents of the second revolution recommend replacing the product-centered approach with the customer-centered approach. This new approach involves developing and providing financial services that the customers want. Evidence suggests that the product-centered orientation is becoming increasingly dysfunctional (Woller 2002). The micro-finance landscape is changing fast, in terms of both time and geography. One consequence is that micro-credit organizations are losing their monopoly over the market to non-institutional sources of credit in Nepal.

Basic Differences

From the functional point of view, the micro-finance revolution is in reality a transformation of the micro-credit revolution that started in the mid-1970s. It explains why the two terms are often used synonymously, and/or the two types of programs are examined under the same heading (Morduck 1999; Ledgerwood 1999). In the context of Nepal, it uses the terms inter-changeably regard the differences between them as semantic rather than substantive.

This benign view looks at the supply side of micro-finance programs. The issue has become critical, as underlined by Yunus (2004a): 'The point is that every time we use the word "microcredit" we should make it clear which type (or cluster of types) of microcredit. Yunus identifies the following categories of micro-credit/micro-finance provider:

Traditional informal micro-credit: moneylenders, pawnshops, friends and relatives, consumer credit in the informal market micro-credit based on traditional informal groups. The activity-based micro-credit through conventional or specialized banks: agricultural credit, livestock credit, fisheries credit, handloom credit, etc.rural credit through specialized banks-operative micro-credit: credit unions, savings and loan associations, savings banks, etc.consumer micro-credit bank/NGO partnership-based micro-credit

Grameen-type micro-credit, or Grameen credit other types of NGO micro-credit other types of non-NGO non-collateralized microcredit. This categorization shows the diverse motives of micro-lenders supplying loans to the poor. For example, micro-credit NGOs and moneylenders have quite different reasons for providing their loan services, with NGOs seeking to help those who are exploited by informal moneylenders because they lack adequate access to institutional sources of credit. It is therefore critical to examine the underlying conceptual differences between micro-credit and micro-finance about poverty alleviation.

There are very few studies that discuss the micro-finance revolution from a conceptual perspective, an important exception being Microfinance and Poverty Alleviation Case Studies from Asia and the Pacific (Remenyi and QuinionesJr 2000). The only difference between micro-finance and the formal banking system is that the latter is geared to rich urban clients, while the market for micro-finance services consists primarily of poor rural people who need credit to pursue their small enterprises in the informal economy. Micro-finance entrepreneurs are usually business people who apply the usual profit motives to meet this demand and seek to be self-financing. Therefore 'subsidized credit and subsidized banking with the poor is inimical to "best practice in microfinance"(Remenyi 2000: 27).

There are two fundamental conceptual differences between micro-credit and micro-finance. The first concerns the profit motive. NGOs or non-profits that run micro-credit programs do not, by definition, seek to make a profit. Micro-finance, however, is a for-profit private venture. The second fundamental conceptual difference concerns how the operations are financed. Micro-credit programs that are run by non-profits depend upon external finance, but micro-finance programs set out to make a profit and must eventually be self-financing. For example, moneylenders use their own money to do their business; they do not approach either national or international donor agencies for investment funds. And national and international development agencies cannot help them to pursue their lending ventures, for obvious reasons.

Current practice in both theoretical and policy discussions would suggest not, since otherwise, professionals would have been far more careful in following these analytical and policy trends. From an academic perspective, the debate deals with human motives for undertaking economic activities.

The importance of this discussion is that ideas of sympathy or social conscience have turned out to be key concepts with poverty-alleviation programs. The World Bank's Community-Driven Development (CDD) initiative (World Bank 2004a) is part of the bottom-up approach to development. Community groups often work in partnership with demand responsibility support organizations and service providers, including local government, the private sector, NGOs, and central government agencies. It refers to institutions, relationships, and norms that shape the quality and quantity of social interactions. Evidence suggests that social cohesion is critical for economic prosperity and sustainable development Social capital, the Bank (2004b) says, is not just the sum of a society's institutions: it is the holds them together. Yunus (1998) is promoting the idea of capitalism that is driven by social awareness. He argues that it is possible to develop capitalist enterprises that maximize profit, subject the fair interests of their customers. The rationale goes as follows: the current neo-classical them of production is incomplete because it is founded on the assumption that individuals businesses solely to maximize their profits. This cannot be a general model of capitalizing however, because it excludes individuals who are concerned about the welfare of others. It consists of traditional capitalists who mainly maximize financial returns. The second comprises philanthropic organizations, such as traditional micro-credit NGOs and public credit agencies, both of which maximize making their investment decision, but must generate a positive financial return. This group includes the micro-finance entrepreneurs, who are socially concerned people, and micro-finance, which is to be treated as a capitalist enterprise that incorporates social awareness. Yunus (2004b) has since defined the third group as belonging to a comprehensive category of social entrepreneurs. They include all those who are willing to offer their time and energy to the task of addressing the social and economic problems faced by groups or communities, whether at the local or the global level. However, Yunus' idea of 'social-consciousness-driven capitalism' runs into the problem of trying to determine whether an individual is entering the micro-lending business with or without social consciousness. Finally, to use micro-credit and micro-finance as synonymous terms seems to contradict how rural development policies have evolved.

Conclusion

In the context of Nepal, it has analyzed the implications of using the terms micro-credit and micro-finance interchangeably and has examined the functional and conceptual perspective. Microcredit programmers provide mainly one kind of service, loan distribution and collection, and financial and organizational activities associated with such operations. The micro-finance program provides a range of financial and organizational services, including credit, savings, insurance, community development. In terms of their functions, it may be argued that the differences semantic rather than substantive. However, the conceptual differences are fundamental and reaching. Most micro-credit programs are run by NGOs that depend on external sources of finance. Micro-finance programs seek to generate enough profit to be self-financing. From an academic and theoretical perspective, the theory of capitalism is founded on assumed selfishness of human nature, a substantial body of economic theory on the so-called third sector deals with the opposite aspect of human nature altruism or sympathy. These conceptual distinctions are of far greater importance than are any functional differences in terms of their theoretical and policy implications.

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