

Nepal: Why microfinance lending has been embroiled in controversies

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Borrowers cite anomalies like exorbitant interest rates for their failure to pay back loans.

In recent weeks, the alleged excesses of the micro-finance institutions (MFIs) against their borrowers have been making the [headlines](#). A group of victims of the MFIs is organising protests against the alleged excesses of the MFIs by forming a struggle committee. The protesters have accused the institutions of charging exorbitant interest rates, high service charges and for misbehaving with their staff. A number of lawmakers have raised the issue in Parliament as well.

What is the problem?

Dil Kumari Karki, who once owned a retail store in Rautahat, now washes dishes in Kathmandu after her business went bankrupt. Initially, she opened a small grocery shop in Rautahat with Rs100,000 borrowed from her neighbours, which she expanded by taking more loans from local lenders and her debt piled up to Rs450,000.

When her creditors began asking for their money back, she turned to the MFIs for more loans. She owed money to 10 creditors, including [five microfinance companies](#)—Forward, Mero Microfinance, Mithila, Deprosc and Sana Kisan.

Her business could not do well, but her debt kept piling up. She complained during an interaction early this week in Kathmandu that due to the high interest being charged by the MFIs, her debts had bloated to Rs4.5 million in the past four years. “The microfinance [institutions] ask for an interest rate of as high as 36 percent a year,” she complained. Many other victims had similar complaints.

The truth behind high interest rates

As per the NRB directive, the MFIs cannot charge an interest rate of over 15 percent a year. “The rule has been in place for the past two years. But the MFIs can add on 1.5 percent in service charge,” said Revati Prasad Nepal, executive director at the microfinance institutions supervision department of the Nepal Rastra Bank (NRB). He suggested that the victims register complaints at the NRB, if any institution charges more than 15 percent interest.

As of the [first quarter](#) of the current fiscal 2022-23, all 64 MFIs have charged interest rates within the limit of 15 percent, according to the NRB data.

Basanta Raj Lamsal, chief executive officer of Vijaya Laghubitta Bittiya Sanstha Limited, said the claim that the MFIs charge more than 15 percent interest is false. “Will any chief executive officer of a micro-finance institution dare to defy the NRB and face punishment?” asked Lamsal. “I have not seen anybody offer proof of any institution charging 36 percent interest rate, as has been claimed.”

He claimed that some borrowers blamed the MFIs even though they had taken out loans from

cooperatives at higher interest rates.

The MFIs however complain of a struggle for survival because of increased cost of funds in the past year-and-a-half due to a [liquidity crunch](#) in the banking system.

The 'A', 'B', and 'C' class banks and financial institutions (BFIs) provide deprived sector lending through the MFIs by providing wholesale loans to the MFIs. "The cost of such wholesale loans to be received by MFIs has risen, but we have not been able to increase lending rates because of the NRB cap," said Lamsal. "As a result, several MFIs are incurring losses."

According to the central bank, [16 MFIs](#) involved in retail lending were operating at a loss at the end of the first quarter of the current fiscal year. The NRB also admitted that the MFIs were struggling to maintain a 15 percent interest rate.

"The average cost of funds of the MFIs is now 13 percent, which is close to the maximum interest rate they can charge," Nepal said.

How did the problem arise?

Both the central bank and the MFIs hold two factors mainly responsible for the borrowers' inability to repay their loans: the Covid-19 pandemic and the liquidity crunch in the banking sector.

"Goods and services generated by borrowers after taking out loans from the BFIs could not be sold in the market due to the pandemic and they failed to repay their loans," said NRB Executive Director Nepal. "People used up the loans from the MFIs for the treatment of their family members who got ill with Covid-19 and they also invested some loan amount in unproductive sectors."

Micro, small and medium enterprises suffered the most during the pandemic, according to a [survey](#) conducted by International Finance Corporation (IFC) in 2020. "Over a half of Nepal's micro, small and medium enterprises face the risk of permanently closing their operations within a month under the current conditions of Covid-19 impacts," the IFC said after the survey in May and June 2020. The central bank [study](#) also said, mostly, the smaller enterprises were hit by the first Covid lockdown in early 2020.

The economy of the country continued to suffer with subsequent global events like the Ukraine war. "As business projects remained at low levels, income generation could not go beyond family sustenance," said Janardan Dev Pant, chief executive officer of Nirdhan Utthan Laghubitta Bittiya Sanstha. "Again, high inflation has rendered disposable income negative in the families at the bottom of the socio-economic pyramid."

How serious is the problem?

Pant said that the gravity of the problem is yet to be assessed systematically. "The problem is not as big as projected but definitely a serious multi-dimensional one," he said.

The NRB estimates that the repayment problems mostly relate to around 100,000 borrowers. There are [3.31 million](#) borrowers from the MFIs as of the first quarter of the current fiscal year 2022-23, according to NRB. The central bank is getting reports that even those who are capable have been reluctant to repay their loans with the hope that the government will bring a loan waiver programme.

"This is a dangerous mindset," said the NRB's Nepal. "It can invite systemic risks because non-repayment by capable borrowers will increase the portion of non-performing assets (NPAs), the

MFIs will then have to make provisions for the NPAs. They may reach a stage where they may be unable to return people's deposits." (The NPA is the amount of loans not paid within the deadline.)

Why multiple lending?

Dil Kumari Karki admitted to having taken out loans from five MFIs. Reports suggest that one big reason people fail to repay the loans of the MFIs is that multiple MFIs offer credit to the same borrower. Lamsal said multiple lendings grew after the MFIs were roped in as members of Credit Information Bureau, two years ago. The MFI can get information about an aspiring borrower whether he or she has outstanding loans from another MFI or any bank or financial institution.

"The MFIs in the past provided loans based on self-declaration of the borrowers that they had not taken loans from other institutions," said Lamsal. "But when the MFIs became the bureau's members, many were found to have taken out loans from multiple sources. Most MFIs gave continuity to their relations with borrowers who were repaying their loans while their businesses ran smoothly."

But the Covid-19 pandemic, liquidity crunch and the ongoing economic slowdown badly hit their businesses. "They could no longer pay back the loans to multiple creditors and they got agitated when multiple MFIs started seeking repayment at the same time," said Lamsal.

Via a [directive](#) on February 22, the central bank barred more than one MFI from providing credit to a single borrower. Before that, there was no restriction on multiple lending. Multiple MFIs could lend to a single borrower without crossing the loan limit [set](#) for a single borrower.

"The MFIs also lent without prudently analysing the risks as it seemed that some loans were taken by clients for household consumption and to service loans taken from previous institutions," said Pant. "As their cash-flow stopped, borrowing from multiple MFIs added to the borrower's financial burden."

Profit-centred MFIs

The MFIs were established with the objective of promoting rural people's access to finance. However, lately, there has been a rush among the MFIs to boost their business and earn more profits.

As a result, the share prices of most MFIs have been higher than many well-run commercial banks. For example, the closing price of the Standard Chartered Bank stood at Rs 515 per share on Friday, while the closing price of the Global IME Bank was Rs191 per share. By contrast, the closing price of CYC Nepal Laghubitta Bittiya Sanstha stood at Rs1,483 per share on Friday while the share price of Global IME Laghubitta Bittiya Sanstha stood at Rs810.

"With the lure of getting more dividends from MFIs, people are buying their shares, driving up their prices."

Lamsal also admits to the profit-centric mindset of MFI promoters. "The CEOs are under pressure from their boards to make higher profits, which forces these MFIs to lend recklessly," he added.

Will the new directive solve the problem?

Pant said that the central bank's new directive was a step in the right direction. "In the case of those who suffered badly during the pandemic, the government should come to their help. They should get more time to make payment."

According to the NRB, the directive was introduced to bring more discipline to the MFIs. According to Nepal, the central bank has also penalised the MFIs which levied more service charge than they were allowed. “We have ordered the MFIs to return service charges to the tune of Rs1.6 billion,” he added.

Prithvi Man Shrestha is a political reporter for The Kathmandu Post, covering the governance-related issues including corruption and irregularities in the government machinery. Before joining The Kathmandu Post in 2009, he worked at nepalnews.com and Rising Nepal primarily covering the issues of political and economic affairs for three years.

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