

RESEARCH BRIEF

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Inclusion of Dalits in Micro Finance Cooperatives in Nepal

Research By
Man Bahadur BK
Research Fellow, 2006

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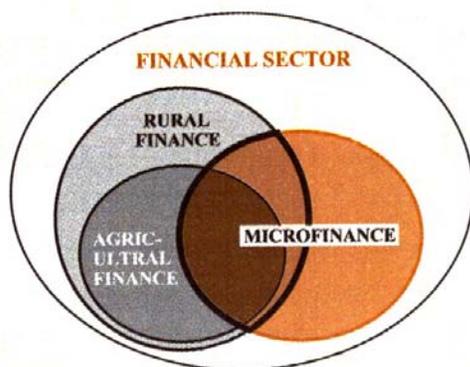


सामाजिक समावेशीकरण अनुसन्धान कोष
SOCIAL INCLUSION RESEARCH FUND

1. Introduction

Micro-finance, a mixed financial product of finance and social intermediation, has evolved as a global concern because it is the financial services of the poor. Specifically, the micro-finance initiatives have economic goals of reducing the poverty and tackling the marginalization of the poor particularly the deprived section of the society. CGAP (2003)¹ has distinguished Microfinance from Rural finance and Agriculture finance and define it as financial services for poor and low-income people. Hence, micro-finance cooperatives operate saving and credit as its main cooperative business. Micro finance commenced in United Kingdom in mid 19th Century through cooperative saving of 28 pounds from factory workers of 'Rochdale society of equitable pioneers'. In Nepal, the first credit cooperative society was formed in Chitwan district of central Nepal in 1956 with an aim to provide the agricultural credit to the flood-stricken people resettled in the Rapti Valley. Nevertheless, the formal micro-finance programme began in Nepal in 1970.

Figure 1: Concept of Microfinance



Source: CGAP (2003)

¹ CGAP. 2003. Financial Services for the Rural Poor: helping to Improve Donor Effectiveness in Micro Finance. Donor Brief No 15. Washington DC: CGAP

Social exclusion discourse developed in response to poverty describes the process that leads the individuals or groups from being wholly or partly excluded from the full participation in the society. Nepal, a Hindu kingdom for a long time; has the caste hierarchical system that dominate the most social and cultural value. The age long caste-based practices have made "Dalits" - the most deprived group in the society - and the representation of Dalits in all socio-economic sectors is negligible. However, there is always debate between social inclusion and sustainability and there is also the argument that the social inclusion spoils the sustainability. Broadly, the research study aims to address the answer for this debate. Further, the research challenges on the traditional head count methodology of social inclusion and highlight the magnitude of involvement in decision making roles. Specifically the research recommends on the new approaches in microfinance to make it more inclusive.

2. Objective

The general objectives of the research are

- To assess and evaluate the inclusiveness in term of access of Dalits in Micro Finance Cooperative (MFC)
- To identify the factors influencing inclusiveness
- To analysis the barriers of inclusion
- To suggest the appropriate measures for social inclusion in the MFCs

3. Research Methodology

In this study, MFCs refer to the Saving and Credit Cooperatives and Small Farmers Cooperatives registered under the Department of Cooperative. The research design is exploratory and

descriptive by nature and the required data and information have been collected using the different methods, namely, structured and semi-structured interviews, survey and focus group discussions. The 420 Saving and Credit Cooperatives associated with NEFSCUN and 169 Small Farmer's Cooperatives associated with Small Farmer's Development Bank has been considered the total sample size. Among these, 58 (10%) cooperatives are selected using stratified sampling methods; ensuring for regional representations. Altogether 314 clients (198 Dalits and 116 Non-Dalits) and 97 Non-clients have been interviewed using structured questionnaires.

4. Key Principal of Micro Finance

The key principles of Micro Finance developed and endorsed by CGAP, its 31 member donors and the Group of Eight leaders are given below:

- The poor need variety of financial services not just loans.
- The microfinance is a powerful instrument against poverty
- The microfinance means building financial systems that serve the poor.
- The financial sustainability is necessary to reach the significant numbers of poor people.
- The microfinance is about building permanent local financial institutions
- The micro credit is not always the answer.
- The interest rate ceilings can damage poor people's access to financial services.
- The government should have a role of an enabler, not a direct provider of financial services.
- The donor subsidies should complement, not compete with private sector capital
- The lack of institutional and human capacity is the key constraint.

- There is importance of financial and outreach transparency.

4.1 Microfinance Models: In 1970s and early 80s, the provision of cheap money to poor farmers and rural micro-entrepreneurs was considered key to stimulate farm and non-farm investment, to boost the use of modern inputs and to augment production in the rural areas. By the mid-1980s, the results achieved by the traditional credit programmes turned out to be disastrous and the critics argued that only few poor people have access to the credit subsidies. It is now generally accepted that the cheap credit was ineffective in stimulating agricultural investments and alleviating rural poverty. Cheap credit undermines the development of a viable rural financial market. Thus, it led to the formulation of a new paradigm of financial market or systems approach. Under this approach, even small farmers are seen as potential source of savings. The poor are generally considered to be able to pay interest. Subsidies are seen to be transitory. Since the system has high risks and costs, a specific financial technology has been developed, tested and adjusted to local needs throughout the last decade (GTZ, 1999)². This financial technology includes followings;

- Social control mechanisms
- Intensive credit monitoring and stringent loan recovery efforts
- Loan portfolio risk diversification measures
- Character-based lending strategy
- Acceptance of non-traditional collateral –joint liability/group guarantee
- Priority on saving mobilization

² GTZ. 1999. *Rural Finance Best Practices, Bhojpur-Sankhuwasabha Poverty Alleviation Through Self- Help Promotion Project*. An Unpublished Seminar Paper. GTZ/ RUFFIN

4.2 Micro Finance Sector in Nepal:

Regarding micro finance sector of Nepal, the models widely practiced in Nepal include : Grameen Bank, Village Bank, Swablamban (Self-reliance), informal groups and Cooperative. The institutional flow chart of these micro finance sectors is provided in Annex 1. Some of the Microfinance Development Banks which are active in microfinance sectors are: Nirdhan Utthan Bank, DEPROSC Bikas Bank, Chhimek Bikas Bank, Swablamban Bikas Bank, Grameen Bikas Bank in regional level promoted by Nepal Rastra Bank and Sana Kisan Bikas Bank promoted by ADB/N. Further, ADB/N, the largest rural credit provider, has been transformed into Small Farmer Cooperative Ltd (SFCL). The group building measures of SFCL is provided in Annex 2.

In term of Nepal's legal and regulatory framework, there are two legal options to facilitate the establishment of MFIs (Dhakal, 2004)³.

- *Community based organization:* These organizations include either SCCs established under Cooperative Act 2048 or NGOs established under Social Registration Act 2034. These organizations also need to obtain license to work as financial intermediary under Financial Intermediary Act 2055. There is no capital requirement provision for these types of organization.
- *Capital based organization:* These organizations include development financial institutions established under Development Bank Act 2052 and registered as a company. There has specified capital requirement provision for this type of organization.

³ Dhakal, Nara Hari. 2004. *Good Practices in Micro Finance Operation: Review of Literature*. A Paper Submitted to TU for Partial Fulfillment of PhD

In term of Demand and Supply of Rural Credit in Nepal, the volume of annual credit demand is NRs 8.4 billion for the year 2001/02. The rural demand of the microfinance has been increasing over the last 12 years. The microfinance institutions are emerging as the major suppliers of funds to rural financial markets. However, they have reduced their supply due to the deteriorating security situation in rural areas.

Table 1: Annual Rural Credit Growth in Banks and Financial Institution (in %)

| Institutions | 2001 | 2002 | 2003 | 2004 |
|---------------|-----------|-----------|-----------|-----------|
| ADBN | 15 | 13 | 12 | 2 |
| CBs | 13 | 22 | 8 | -9 |
| MFDBs | 34 | 48 | 24 | 7 |
| Coop & FINGOs | 200 | -16 | -44 | -9 |
| Total | 15 | 17 | 10 | -1 |

Source: Poudel, 2062⁴

5. Building Inclusive Microfinance

Summing up the procedures developed by different global summit on Micro Finance, micro finance can be made inclusive in following way:

- Build institutional capacity to reach the poorest families by 1)strengthening network and exchange practice in existing micro-credit institutions and 2) preparing new practitioners through a training;
- Support on the development of regulation and financing systems that empower the poor and the institutions that serve them;
- Support on development and use of cost-effective poverty assessment tools to chart the movement of clients above the US\$ 1 a day threshold;
- Complete, submit and implement an Institutional Action Plan annually

⁴ Poudel, Shree Prasad. 2005. Market- Based Reforms and Rural Financial Market in. *Nepal Rastra Bank Samachar, Annual Especial Issue*. Nepal: Nepal Rastra Bank

outlining to fulfill the two goals: 1) Work with 175 million world's poor, especially the women by 2015 and 2) Work to move out 100 million world's poor from poverty by 2015

- Conduct a media campaign to expand awareness, accelerate implementation and enlist new participants in the Campaign;
- Support on the promotion of Campaign's learning agenda and encourages the submission and fulfillment of Institutional Action Plans.

Inequity and Marginalization in Nepal:

In Asia, Nepal has the most unequal distribution in poverty and the pattern of inequality has increasing trend. Nepal, with unequal growth across urban and rural areas, has been an important factor underlying the substantial increases in inequality. Since poverty and ethno-caste hierarchy is interlinked in Nepal, it has not been successful to alleviate poverty. Many policies and programmes were implemented by the government under different development plans to curb the poverty situation of the country. Since poverty and ethno-caste hierarchy is interlinked in Nepal, it has not been successful to alleviate poverty. An inclusive Microfinance programme can be pertinent instruments for economic empowerment and instrumental for enhancing democratization process at grassroots level. In addition, it is relevant for achieving MDGs by reaching poorest of the poor people.

6. Social Performance Measurement

Social performance can be defined as "the effective translation of an organization's social mission into practice. Social performance is not just about measuring the outcomes but also about the actions and corrective measures that are being taken to bring about those outcomes" (SEEP Network,

2006)⁵. Social performance measurement (SPM) is important for microfinance institutions in the following ways;

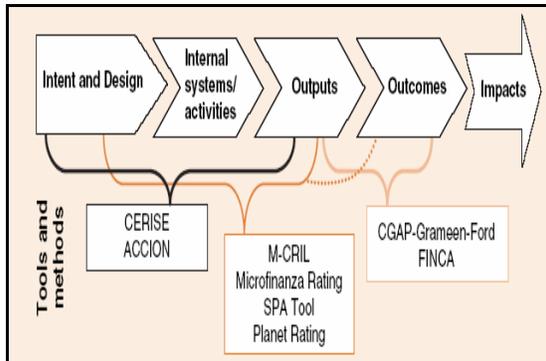
- Focusing on financial performance indicators alone gives an incomplete picture of the microfinance institution. If the social impacts and processes leading to those impacts are not factored, a sound financial institution can cause harm in a community.
- By relying solely on financial indicators, a microfinance institution may experience a mission drift when social objectives are replaced by purely financial ones.
- Social organizations or investors need information on social performance in order to have a basis for planning and decision-making. The lack of social performance information hinders the private investment in microfinance by making information acquisition on social risks and returns more difficult and costly.
- The absence of social performance information diverts private investment in microfinance towards a relatively small number of "safe" investments
- Private investors in microfinance expect transparency and full disclosure, not only of financial data but also of social performance.

The figure (5.2) shows social performance assessment process and

⁵ SEEP NETWORK. 2006. *Micro Finance and Non-Financial Services for Very Poor: Dragging Deeper to Find Keys to Success*. SEEP NETWORK Poverty Outreach Working Group

what tools can be used during the individual steps.

Figure 2: Tools for Assessing Social Performance



Source: CGAP (2007)⁶

7. Importance of SPM in Nepal

There are two more reasons why Social Performance Measurement (SPM) should be of great importance to Nepal's microfinance institutions in particular. Firstly, discrimination of certain ethnic and religious groups as well as women and low caste members has led to huge disparities in income distribution. Secondly, in the current fragile political situation, microfinance practitioners need to be able to show the social impacts and benefits that they bring to the communities.

7.1 Analysis of Field Survey: The level of inclusion is categorized into four levels on the basis of Social Inclusion Factor (SIF) which is a new method to measure inclusion specifically Governance, Management and Outreach. The four levels includes: (1) greater than 0.5 highly inclusive, (2) 0.2 to 0.5 moderately inclusive, (3) 0.1 to 0.2 less inclusive and (4) less than 0.1 negligible inclusive. The region wise analysis of SIF in provided in Annex 3.

The ethno-caste segregation of members associated with executive committee, accounts committee and local committee is dominated by Brahmin/ Chhettri, Janajati and Dalits. Internal management problem within MFIs is a leading cause of failure to expand even where demand and repayment rates are high (UNCDF, 2006)⁷. The positions regarding the management of co-operatives show that they are mostly managed by Janajati and Brahmin/Chhetri. The caste wise representations in various working area of MFI is provided in annex 4.

On an average, the proportion of borrowers to total members is 51%; the ratio of Dalit male borrowers is 60% which is higher to other members; the ratio of female borrowers was only 42% as against other members. The member/ borrower ratio is provided in table 2.

Table 2: Member/ Borrower Ratio (in %)

| Caste/ Ethnicity | Male | Female | Total |
|------------------|------|--------|-------|
| Brahmin/ Chhetri | 51.4 | 52.6 | 52.1 |
| Janajati | 47.7 | 53.7 | 51.1 |
| Dalits | 59.9 | 41.8 | 50.1 |
| Total | 51.0 | 51.7 | 51.4 |

(Source: Field Survey, 2007)

The major function of the cooperative is to mobilize the saving. However, only 13% were the saving members from Dalit community (Table 3).

Table 3: Number and Share of Savers

| Caste/ Ethnicity | Male | | Female | |
|------------------|--------------|------------|--------------|------------|
| | No | % | No | % |
| Brahmin/Chhetri | 5421 | 43.04 | 7137 | 43.46 |
| Janajati | 5414 | 42.99 | 7223 | 43.98 |
| Dalit | 1759 | 13.97 | 2062 | 12.56 |
| Total | 12594 | 100 | 16422 | 100 |

(Source: Field Survey, 2007)

There is less Involvement of Dalits in the training provided in last five years in surveyed cooperatives (Table 4).

⁶ CGAP. 2007. *Beyond Good Intentions: Measuring the Social Performance of Micro Finance Institution*. Focus Note No 41. Washington: CGAP

⁷ UNCDF. 2006. *International Year of Micro Credit 2005, Final Report*. UNCDF

Table 4: Member's Training Details

| Caste /Ethnicity | Male | | Female | |
|------------------|------------|------------|-------------|------------|
| | No | % | No | % |
| Brahmin/Chhetri | 489 | 61.6 | 814 | 55.7 |
| Janajati | 231 | 29.1 | 537 | 36.7 |
| Dalit | 74 | 9.3 | 110 | 7.6 |
| Total | 794 | 100 | 1461 | 100 |

(Source: Field Survey, 2007)

The social inclusion factor will improve the performances of Micro Credit Cooperative (MFC). The MFCs running in profit has 0.0547 mean SI factor whereas the MFCs running in loss has 0.0322 mean SI factor (Table 5).

Table5: Mean Social Inclusion Factor vis-à-vis Profit/ Loss Situation in MFC

| Organization | Mean SI Factor | No of MFCs | Percent |
|---------------|----------------|------------|---------|
| MFC in Profit | 0.0547 | 53 | 91.4 |
| MFC in Loss | 0.0332 | 5 | 8.6 |
| Total | 0.052 | 58 | 100 |

(Source: Field Survey, 2007)

7.2 Variable Influencing Social Inclusion Factor in MFC:

The variables influencing social inclusion of Dalits in microfinance co-operative can be categorized into two levels: i) organizational and ii) individual level. In organisational level, the factor influencing inclusion are: i) policy framework; ii) Credit Methodology; iii) Product Mix and Product Design iv) Nature of Source of Lending v) Social Structure of Locality vi) Age of Cooperative and vii) Demography of Working Area. In individual level, the factors influencing inclusion are: i) Self Exclusion ii) Exclusion by the Staff; iii) Exclusion by Other Members and iv) Exclusion by Design. In the field survey, we find that the MFCs are able to reach the middle class village people especially so called "upper castes". The major causes of barrier are social inclusion in executive committee, low educational qualification for employment and stigmatization due cultural background.

7.3 Barriers of Reaching Most Deprived Groups:

The barrier in reaching the most deprived group includes: Physical Barriers, Economic Barriers and Socio-cultural Barriers. In physical barrier, very poor people live in remote rural areas that have no access to financial services. In economic barrier, most microfinance program uses group-lending methodology where the clients attend a weekly or monthly meeting to access credit. The cost of transportation to these meetings, together with the opportunity cost of attendance can be a barrier for poor people to participate in microfinance programs. In term of socio-cultural barrier, poor are socially intimidated, believing that the services offered by micro finance is not suited to their needs.

8. Recommendation:

On the basis of the findings of the study, the recommendations are suggested in following four prospects.

8.1 Institutional Policy: The criteria and rules of the co-operatives are not poor-friendly, in fact, they serve as an obstacle to inclusion and need to be changed. There is the need to adopt Dalit friendly and inclusive policy for membership distribution and service delivery.

8.2 Public Policy and Plan: The existing laws and regulations need to be revise and fine tune. The government has to support the microfinance co-operative sector by formulating better policies and reforming law, regulation and supervisory framework.

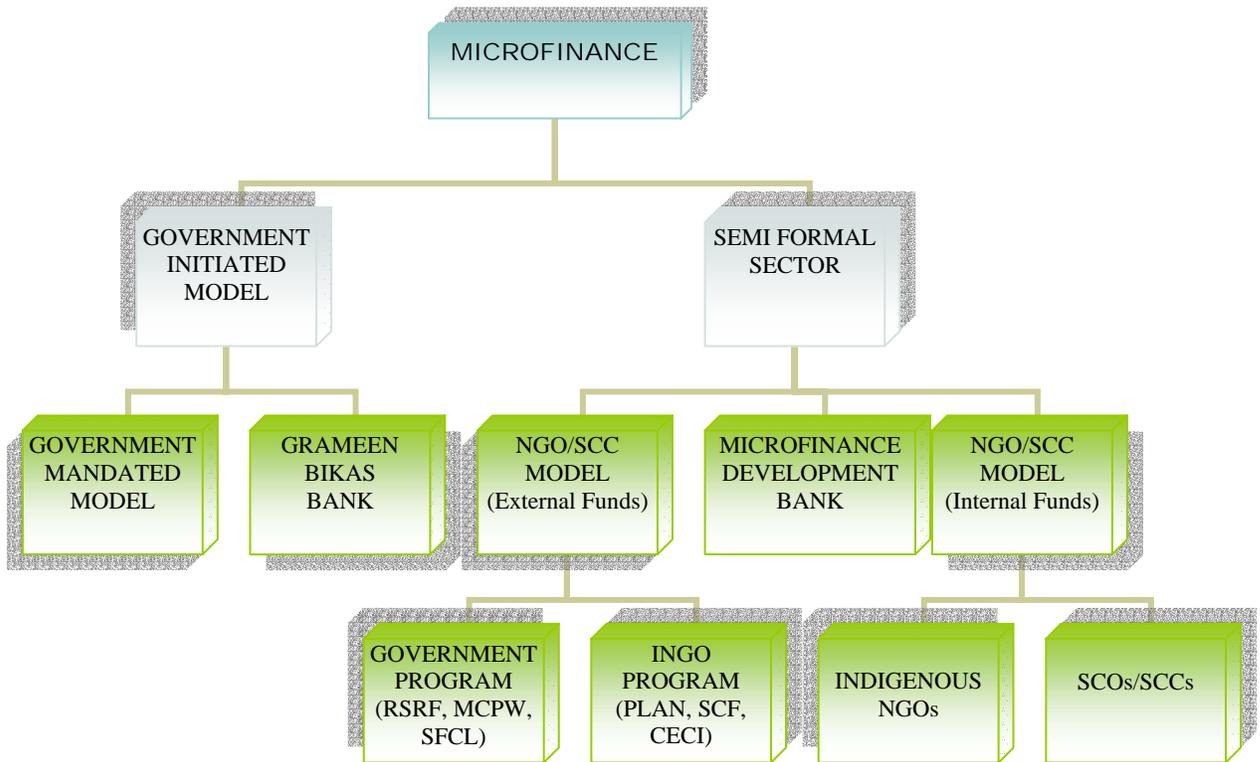
8.3 Stakeholders' Concern: MFI should establish working relationship with FNCCI and its district chapters to access different facilities and support that may be available. Further MFI needs to develop the effective

networking and advocacy in order to share knowledge, information and experience in a regular for more inclusive approach.

8.4 Civil Society Perspective: The civil societies need to educate people

against caste-based discrimination. The ethno- caste-based discrimination is the root cause of exclusion of deprived communities from every sector of public life

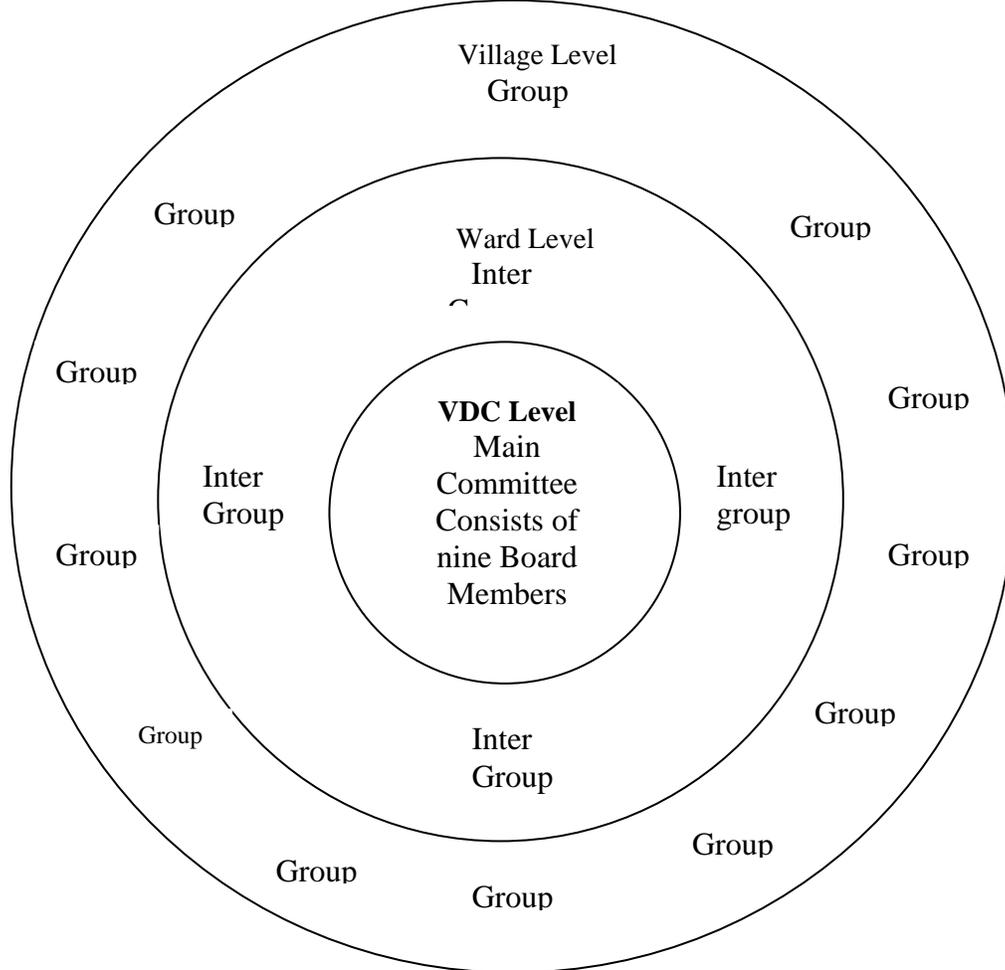
Annex 1: Microfinance Sectors in Nepal



Source: Dhakal, 2004⁸

⁸ ibid

Annex 2: SFCL's Group Building Model



Source: Shrestha, 2003⁹

⁹ Shrestha, Mahendra P. 2006. 50 Years of Cooperative Movement in Nepal: Is it Enough in *Sahakari Sambad Annual Issue – 2006*. Nepal: NCDB

Annex 3: Region-wise Social Inclusion Factor

| Level of Inclusion | Eastern | Central | Western | Mid-west | Far-west | Total | % |
|--------------------------------------|----------|-----------|-----------|----------|----------|-----------|------------|
| Highly Inclusive (SIF > 0.5) | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Moderately Inclusive (SIF > 0.2-0.5) | 0 | 1 | 1 | 0 | 0 | 2 | 3.45 |
| Less Inclusive (SIF > 0.1-0.2) | 0 | 4 | 1 | 1 | 1 | 7 | 12.07 |
| Negligible Inclusion (SIF < 0.1) | 7 | 29 | 8 | 4 | 1 | 49 | 84.48 |
| Total | 7 | 34 | 10 | 5 | 2 | 58 | 100 |
| MCF with zero SFI | 2 | 6 | 0 | 0 | 0 | 8 | 13.79 |

(Source: Field Survey, 2007)

Annex 4: Caste Wise Representation in Various Working Areas of MFI (in %)

| Caste/ Ethnicity | Population | Governance | Management | General Member/ Clients |
|------------------|------------|------------|------------|-------------------------|
| Brahmin/ Chhetri | 36 | 58 | 58 | 44 |
| Janajati | 60 | 39 | 41 | 43 |
| Dalits | 4 | 3 | 1 | 13 |

(Source: Field Survey, 2007)

Social Inclusion Research Fund (SIRF): An Introduction

As a follow-up to an assessment of Norwegian support to NGOs in Nepal (2001), the Royal Norwegian Embassy, Kathmandu, envisaged a need to stimulate further research on processes of national building, social exclusion and poverty, and the role of the civil society in Nepal. As per the report titled “Social Exclusion and Nation building – Assessment of prospects for enhancing the role of research and research institutions in Nepal” (June 2003), the Government of Nepal and Royal Norwegian Embassy at Kathmandu, agreed in 2005, to establish a *Research Fund* and support *research cooperation* between a Norwegian and a Nepali research institution to carry out research on issues of social exclusion. SNV Nepal was invited to manage the research fund.

The *main objectives* of the Social Inclusion Research Fund (SIRF) are as follows:

- Produce high quality and critical research on causes of social exclusion in Nepal and ways to accommodate and manage diversity.
- Make social science research more relevant to excluded and disadvantaged groups and their agendas.
- Ensure that research more effectively contributes to policy and public debate and a deliberative democratic process

A total of 25 Research Fellowships were awarded in 2006 and 2007. A total of 150 Apprenticeship Grants have been awarded in 2006 and 2007. Two Norwegian research institutions and five Nepali research institutions are cooperating in carrying out research and have published eight research papers.

SIRF is in the process of carrying out policy dialogue with the political party leaders, government agencies and civil society organisation through dissemination of critical discourse related to the outcome of the research programme, as well as allowing for advocacy groups to “take back” and use the research results for their own purpose. SIRF is also working with political party leaders and Constituent Assembly (CA) members to make the Constitution more inclusive.

The Government of Nepal is initiating the process of making the Fund an independent autonomous body under the new law to be enacted by parliament.



Social Inclusion Research Fund (SIRF)

Secretariat, SNV Nepal

Bakhundole, Lalitpur, P.O. Box 1966, Kathmandu, Nepal

Telephone: +977-[0] 1-5523444, Telefax: +977-[0] 1-5523155

E-mail: info@socialinclusion.org.np, Website: www.socialinclusion.org.np; www.snvworld.org