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Research Article

Microfinance in Nepal: Historical Evolution, Institutional Growth, and Sustainable Consolidation

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Abstract: *Microfinance involves providing small loans to the underprivileged to support cottage and small-scale businesses that can generate income to meet borrowers' obligations. The objective of the study is to analyze the historical development, modalities, regulations, and institutional growth of microfinance in Nepal. In Nepal, the microfinance sector has steadily expanded over the past five decades through initiatives such as cooperative credit schemes, the Small Farmers Development Project, targeted lending to deprived sectors, and the establishment of Grameen Bikas Banks, thereby enabling broader access to credit and income-generating opportunities. This study analyzed the growth of Microfinance Financial Institutions (MFIs) from fiscal year 2016/17 to 2023/24 using secondary data from Nepal Rastra Bank, focusing on the number of institutions, assets, branches, staff, borrowers, and loan portfolios. The findings showed rapid growth in the early years, with MFIs increasing from 53 to 90 between 2016/17 and 2018/19, assets nearly doubling, and borrowers reaching 2.68 million. Borrower outreach peaked at 3.3 million in 2021/22, indicating intense penetration. However, consolidation followed, with the number of MFIs declining to 52 and borrowers decreasing to 2.66 million in 2023/24. Despite this, assets increased to Rs. 554 billion, and loans rose to Rs. 456 billion, indicating stronger financial capacity and larger loan sizes. Nepal's microfinance sector is shifting from rapid growth to sustainable consolidation. Microfinance in Nepal remains a key driver of rural development, balancing financial sustainability with social goals.*

Keywords: *Institutional Growth, Microfinance, Nepalese Microfinance Institutions.*

I. INTRODUCTION

Microfinance is a financial service that provides small-scale financial products, including microcredit loans, savings, and insurance, to individuals who lack access to traditional banking services. This is especially true for those living at the bottom of the economic pyramid. The main goal of microfinance is to support entrepreneurship and reduce poverty by empowering people to start or grow small businesses, helping improve their livelihood and economic status (Bakhtiari, 2011; Newman et al., 2017).

Microfinance institutions (MFIs) have played a crucial role in promoting sustainable development through financial services designed for micro-entrepreneurs. For example, microfinance programs have shown significant positive effects on poverty reduction by helping beneficiaries improve their living standards and boost their income levels (Khanam et al., 2018).

With the launch of the Grameen Bank project in Bangladesh in 1974, microfinance has its roots. In 1976, Muhammad Yunus, a professor at the University of Chittagong in Bangladesh and the 2006 Nobel Peace Prize winner, founded Grameen Bank, also known as Rural Bank (Kasali et al., 2015). Through its lending programs, the bank primarily served rural women. It established the social security group lending program to offer credit to the underprivileged, who previously could not access it from traditional banks because they lacked tangible collateral.

The concept of joint liability, which allows group members to supervise loan disbursement and repayment, underpins group financing. When a member defaults, other members are held responsible and must later contribute from shared resources to prevent future loan rejections for other members. The main goal of this approach is to empower women and enable them to participate in household decision-making. Following its success, the idea of microfinance was adopted by several industrialized and developing countries. MFIs aim to include individuals who are currently unbanked to empower women by reducing poverty and increasing their control over family finances (Yunus, 2003). In the microfinance sector, women constitute the majority of borrowers at these institutions.

The main goal of MFIs is to provide their clients with both financial and non-financial services that support their efforts to: (i) eliminate poverty; (ii) empower women and other marginalized groups; (iii) create jobs; and (iv) promote the socioeconomic transformation of society (Dhungana, 2018).

The phrase "micro-finance" refers to financial services provided to small businesses and underserved groups in areas such as savings, credit, remittance, microinsurance, and other services to help them create opportunities for self-employment and additional income sources. The main features of microfinance include small loans, group lending, savings groups, small-scale entrepreneurs, diverse usage, quick repayment, careful oversight, and simple terms and conditions on credit (without collateral) (Nepal Rastra Bank, 2013).

In the Nepalese context, microfinance institutions, classified as 'D' banks and authorized by the Nepal Rastra Bank (NRB), the central bank of Nepal, are vital in meeting the financial needs of people and small businesses that lack access to traditional banking services. These organizations play a key role in providing micro-credit and other financial services to underserved individuals with little or no capital. Most microfinance institution customers in Nepal are impoverished women who lack access to banks or other financial institutions.

The objective of the study is to analyse the historical development, modalities, regulations, and institutional growth of microfinance in Nepal.

II. HISTORICAL DEVELOPMENT OF MICROFINANCE INSTITUTIONS IN NEPAL

The first 13 credit cooperatives were established in the Rapti Valley of the Chitwan region in 1956. This marked the start of efforts to develop microfinance services in Nepal. These cooperatives aimed to provide credit to residents affected by floods in the valley. Before this, only unofficial sources could meet the credit needs of the rural sector. In 1974, the NRB directed the two existing commercial banks to allocate at least 5% of their total deposits to the "small sector."

In 1976, the operations eligible for credit were redesignated as the "priority sector" to include the service, cottage, and agricultural sectors. Currently, CBs are required to lend at least 12 percent of their entire loan portfolio—including loans from the underprivileged sector—to this industry. This instruction compelled CBs to engage in rural lending in Nepal for the first time. The "Deprived Sector Credit Program" was launched by NRB in 1990, requiring CBs to lend between 0.25 and 3.00 percent of their total loan portfolio to the extremely poor. Penalties are imposed for shortfalls if the target is not met (Sharma, 2003).

To meet the financial needs of small farmers, ADB/N launched the well-organized and specialized "Small Farmer Development Project (SFDP)" as a pilot in November 1975. This nationwide project aims to group "small farmers" into small credit groups and provide financing based on group guarantees. This project marked Nepal's first introduction to the concepts of group building and group-based lending as alternatives to tangible collateral. Since 1993–1994, efforts to institutionalize small farmer organizations into the "Small Farmer Cooperative Limited" have been underway. The goal of this program is to establish locally owned and operated MFIs capable of independently managing the SFDP's operations. The 32 districts had 125 of these SFCLs operating by the middle of January 2003.

The "Intensive Banking Program (IBP)" was launched by NRB in 1981, and it required commercial banks (CBs) to lend a specific portion of their priority sector loans—as group loans—to individuals below the federal poverty line. Loans under this scheme are provided to group members based on group guarantees; no physical collateral is needed from the bank. Nabil eventually adopted IBP, which NBL and RBB had initially started. In 1982, the Ministry of Local Development (MLD) launched its first women-focused socioeconomic program, "Production Credit for Rural Women (PCRW)," in partnership with UNICEF, NRB, CBs, and ADB/N. As part of this program, low-income women were organized into small credit groups, MLD staff provided necessary skill training, and partner banks extended group-based loans. Fifty-five districts are participating in this initiative.

With funding from the ADB, MLD launched a second project in 1994 called the "Microcredit Project for Women (MCPW)." It included a clause allowing NGOs to act as financial middlemen. The project was implemented in five municipalities and twelve districts. By June 30, 2002, the project had helped 27 NGOs become FI-NGOs and promoted 82 CBOs into SCCs.

The Nepali government established the "Rural Self-Reliance Fund" in 1990, with an allocation of Rs. 10 million in the FY 1991–1992 budget. In the following fiscal year, the government again contributed Rs. 10 million to the Fund. The purpose of the Fund is to provide bulk loans to NGOs and SCCs, which then lend to the impoverished rural populations. Besides the formal financial institutions, the Government of Nepal, the NRB, and each of the five development regions set up five regional "Grameen Bikas Banks" to imitate Grameen Banks. Between 1992 and 1998, they also created a second-tier institution called the "Rural Microfinance Development Centre (RMDC)." During this period, two other organizations—"Nirdhan" and CSD-SBP—began operating as Grameen Bank replicas within the NGO sector. Later, "Nirdhan Utthan Bank" and "Swabalamban Bikas Bank" were promoted by these NGOs as microfinance development banks (Sharma, 2003).

A provision of the Banks and Financial Institutions Ordinance (2004; renamed as an Act in 2006) allows microfinance banks to be licensed as class 'D' banks. As a result, the NRB has licensed 52 microfinance banks so far. The government established the Rural Self-Reliant Fund in 1991 with a Rs. 20 million government contribution to provide small wholesale funds to cooperatives and non-governmental organizations (NGOs) that lend money to low-income groups.

In 1998, the government, with support from ADB and NRB, also established the Rural Microfinance Development Centre Limited (RMDC) to provide larger wholesale loans to MFIs under the Rural Microfinance Project (RMP) with ADB assistance. After RMDC began operations, several MFIs entered the microfinance industry, and the pace at which these institutions expanded their reach also increased. In 2001, to supply wholesale financing to the Small Farmers Cooperative Limited (SFCL), the government created another wholesaler, the Sana Kisan Bikas Bank Limited (SKBBL). As a result of these programs and initiatives, the microfinance sector has experienced renewed growth. Additionally, the government's numerous rural and community development programs, along with support from donors, helped these self-help groups by providing small loans to their members as grants for initial capital (Shrestha, 2009).

Nepal has nearly fifty years of experience with microfinance. Only microfinance programs are considered pro-poor and focus on rural areas, even though several programs have been launched in Nepal to reduce poverty. Nepal Rastra Bank has established a variety of microfinance development programs, such as the deprived sector credit program and other donor-supported microcredit initiatives (Nepal Rastra Bank, 2013).

For the following three fundamental reasons, microfinance has been identified as a particularly effective development intervention:

- The services offered through microfinance can be explicitly targeted to the poor and the poorest of the poor;
- These services can significantly improve the socioeconomic status of the targeted community;
- The institutions that provide these services can transform into long-lasting, sustainably expanding organizations in a matter of years.

In Nepal, rugged topography, isolation, diverse populations and cultures, among other factors, make it hard to deliver microfinance. To serve the needs of the underprivileged by providing banking and financial services and helping to improve their economic and social conditions, microfinance institutions are specialized organizations that focus on income-generating activities. According to specific outreach research on microfinance, poor and rural households living in remote terai, hill, and mountain regions are often unaware of microfinance programs. Research indicates that microfinance operations tend to be more costly in higher hill and mountain areas. This situation urges Nepal to develop or adopt a unique, locally sustainable microfinance model that can make a real difference in these regions. Such a model could enhance the socioeconomic status of low-income households, boost employment by encouraging SMEs, and ultimately break the cycle of poverty and deprivation (Nepal Rastra Bank, 2013).

III. MODALITIES OF THE NEPALESE MICROFINANCE SECTOR

In Nepal, microfinance initiatives are introduced and supported through various approaches and strategies. The following are some of the models that have been successfully implemented (Nepal Rastra Bank, 2013): Grameen banking; lending to the deprived sector; Small Farmers' Cooperatives; Financial Non-Governmental Organizations (FINGOs); Savings and Credit Cooperatives (SACCOs); project-based microcredit, wholesale lending, and Small Farmers' Cooperatives.

In Nepal, the Grameen banking model was introduced in 1992. As of mid-April 2013, there were 28 microcredit development banks, including three wholesale lending organizations and five regionally focused rural development banks. The program to lend to the deprived sector began in the 1991–1992 fiscal year.

A certain percentage of the total loan portfolio must be allocated by commercial banks (Class-A), development banks (Class-B), and finance companies (Class-C) to meet the deprived sector lending requirement.

In 1990, the Nepali government established the Rural Self-Reliance Fund (RSRF) to boost income and provide work possibilities for the underprivileged living in rural areas. Through co-ops, RSRF offers wholesale credit for on-lending purposes to the underprivileged. Through Agricultural Development Bank Ltd., it offers long-term loans to industries including cold storage, tea, and cardamom.

Cooperatives focused on agriculture were established in Nepal in the 1950s as a precursor to microfinance. After being renamed as Small Farmers' Cooperative Limited (SFCLs), the Small Farmers' Development Project (SFDP) is now run by the farmers themselves.

Savings and credit cooperatives (SACCOs) and financial non-governmental organizations (FINGOS) both use a community-based approach for their microcredit operations, essentially limiting their banking services to their members. Such institutions were no longer granted licenses by Nepal Rastra Bank.

Previously supported by donors, several major project-based microcredit programs were implemented, including Production Credit for Rural Women (PCRW), Micro-credit Program for Women (MCPW), Poverty Alleviation Project in Western Tarai (PAPWT), Third Livestock Development Project (TLDP), Rural Microfinance Program (RMP), and Community Ground Water Irrigation Service Project (CGISP). The completed Enhancing Access to Financial Services (EAFS) Project, funded by the United Nations Capital Development Fund (UNCDF) and the United Nations Development Programme (UNDP), was concluded in March 2013.

The Rural Self-Reliance Fund (RSRF), Rural Microfinance Development Center Ltd. (RMDC), Sana Kisan Bikas Bank Limited (SKBBL), and First Microfinance Development Bank Ltd. (FMDBL) are programs that provide wholesale microcredit.

Additionally, several self-help organizations offer rural residents' access to microfinance services. Even though there are more MFIs in Nepal than ever before, their microfinance services still fall short of what is needed.

IV. REGULATION RELATED TO MICROFINANCE IN NEPAL

Nepal Rastra Bank issued a regulation for the microfinance industry. In 2003, the Micro-Finance Development Banks (MFDBs) became subject to prudential regulation. This regulation was amended and took effect in January 2004. According to the Banks and Financial entities, 2006, MFDBs are classified as "D" class financial entities.

The following are some of the main regulatory provisions issued to MFDBs:

- Minimum paid-up capital of Rs. One hundred million is required to open an MFDB at the national level; similarly, MFDBs intended to operate at the regional level, excluding the Kathmandu Valley, must have minimum paid-up capital of Rs. 60 million; MFDBs intended to operate in four to ten districts, excluding the Kathmandu Valley, must have minimum paid-up capital of Rs. 20 million; and MFDBs intended to operate in three districts outside of Kathmandu Valley require up to Rs. 10 million in paid-up capital.
- Establishing a proposed MFDB requires the support of at least seven promoters. The promoters may hold up to 70% of the shares. The public should be able to purchase shares representing at least 30% of the entire share capital. These investors may own a minimum of 20 percent and a maximum of 85 percent of the foreign stake, including category "D".
- MFDBs can mobilize financial resources up to 30 times the core capital. Based on their risk-weighted assets, MFDBs must maintain a minimum of 4% in core capital (Tier-I) and 8% in total capital. These funds come in the form of deposits, special savings accounts, and loans.
- MFDBs must keep a minimum amount of liquid assets and a specified cash reserve as a percentage of their total financial resources.

For those institutions that take deposits from the public, further provisions have been provided:

- Nepal Rastra Bank gives special attention to MFDBs operating in rural regions when granting operational licenses.
- In order to improve the dependability, sustainability, competence, and effectiveness of microfinance businesses in terms of service delivery, the NRB implemented additional prudential regulations in mid-April 2003, specifically for MFDB operating in the nation.
- The ageing of past-due loans from MFDBs will be used to categorize these loans into four groups: pass (loans past due up to three months), sub-standard (loans past due between three and six months), dubious (loans past due between six and a year), and loss (loans past due by a year or more).
- In order to merge, close, or expand their branches within the designated regions, MFDBs must obtain NRB clearance. MFDBs need board approval for their respective business plans before they can open a new branch.
- To operate micro and small businesses, MFDBs can lend up to Rs. 100,000 to group members without the need for collateral, while banks can grant loans up to Rs. 300,000 based on collateral.
- It should be the goal of every MFDB to sustain a strong corporate governance culture.

V. STUDIES OF MICROFINANCE IN NEPAL

Sharma (2003) analyzed the challenges faced by formal and semi-formal microfinance organizations and programs in achieving financial sustainability, as well as the access they provided and the jobs they created. He also mentioned that, due to the rising demand for microfinance services in terms of volume and coverage, NRB needs to improve its capacity to oversee, regulate, and monitor a large number of MFIs. Additionally, it must develop innovative and suitable credit policies and regulations that create an environment enabling MFIs to grow and maintain strong financial health.

According to Regmi (2013), preserving women's savings and credit groups, understanding the context of poverty and its vulnerabilities, the process by which members' households gather and interact with their livelihood assets, and combining livelihood activities with the use of these assets to maximize income and reduce vulnerability are all important steps toward reducing poverty. His research also revealed the increasing barriers faced by MFIs in their efforts to alleviate poverty, as well as stakeholders' perspectives on MFIs.

Karn (2018) found that MFIs face several challenges, including limited resources, unhealthy competition, seasonal migration, political ignorance, exclusion of disadvantaged populations, threats to financial discipline, and poor understanding of microfinance organizations. Dhungana (2018) revealed that the establishment of micro-businesses and enterprises by individuals has significantly increased after participating in micro-finance programs, allowing them to create self-employment and job opportunities through the micro-credit services of MFIs in Nepal.

Adhikari (2019) found that the socio-economic status of borrowers from Nepalese microfinance institutions is higher than that of non-borrowers, suggesting that microfinance effectively helps improve the socio-economic status of impoverished women. According to Shrestha (2020), COVID-19 has had a significant negative impact on microfinance institutions. However, they survived the review period with the support of NRB policy measures and some resilience. The increasing number of past-due borrowers indicates that the spread of COVID-19 is ongoing and that there are still considerable risks.

Thapa (2021) observed that microfinance positively impacts the living standards of underprivileged and impoverished individuals in Nepal who participate in microfinance institution programs. Lamichhane (2022) found that effective product design and delivery, prevention of excessive debt, transparency, responsible pricing, fair treatment of clients, protection of client data, and complaint resolution mechanisms are key strategies for ensuring the operational and financial sustainability of microfinance institutions in Nepal.

Subedi and Karki (2022) examined the relationship between the sustainability and depth of MFIs, finding a significant trade-off between them. Chaulagain and Lamichhane (2022) demonstrated a strong link between MFI performance and factors such as information technology, loan lending procedures, and the regulatory environment. They also discovered that the success of MFIs is positively associated with and greatly influenced by the loan lending system, regulatory framework, information technology, staff motivation, management system, and effective risk management.

In another study focused on the microfinance sector, Yadav (2024) found that the number of microfinance user groups, total group figures, progress of borrowing staff, outstanding loans, profits, active loans, and savings all declined from 2020/2021 to 2022/2023, while the ratio of overdue members, passive loans, and non-performing loans (NPL) increased during this period. Thapa and Yadav (2024) found that after participating in microfinance programs, there was a significant improvement in women's status regarding asset ownership, decision-making independence, mobility, and social recognition in Nepal. Taking panel data from 21 microfinance institutions from 2016/17 AD to 2023/24 AD, Hakuduwal and Nayabhari (2025) found that number of operation year, number of branch and number of active borrowers has positive significant impact on borrower per staff but number of staff, average loan size, and cost per loan has negative significant impact on productivity of Nepalese microfinance institutions.

VI. GROWTH OF MICROFINANCE

The growth of microfinance institutions can be studied in terms of the number of MFIs, branches of MFIs, total staff, total assets, total borrowers, total loans, and advances of MFIs.

The data presented in Table 1 shows a significant growth in Nepal's microfinance sector from 2016/17 to 2023/24, despite some fluctuations in recent years. The total assets of Microfinance Financial Institutions (MFIs) increased markedly, from Rs. 134 billion in 2016/17 to Rs. 554 billion in 2023/24, indicating stronger financial stability and broader outreach. Likewise, loans and advances grew from Rs. 106 billion to Rs. 456 billion during the same period, reflecting increased lending capacity and higher demand for microcredit.

Table 1: Growth of Microfinance

Fiscal Year	Number	Assets (Rs. in billions)	Branches	Staff	Borrower	Loan and Advances (Rs. in billions)
2016/17	53	134	1,895	9,602	1,633,620	106
2017/18	65	176	2,450	11,557	1,853,586	146
2018/19	90	273	3,547	17,362	2,680,809	235

2019/20	85	325	4,057	19,017	2,783,222	263
2020/21	70	446	4,685	20,872	2,992,068	366
2021/22	65	520	5,135	23,303	3,303,100	450
2022/23	57	508	5,128	22,493	2,984,420	432
2023/24	52	554	5,051	21,727	2,663,510	456

Note. Monthly statistics of Nepal Rastra Bank, 2024

The number of branches expanded from 1,895 to 5,051, and staff numbers went up from 9,602 to 21,727, demonstrating organizational growth and efforts to enhance service delivery. The number of borrowers also rose from 1.63 million to a peak of 3.3 million in 2021/22, underscoring the expanding reach of microfinance services among low-income groups.

However, recent years show signs of consolidation and slight contraction. From 2021/22 onward, the number of MFIs decreased from 65 to 52, branches slightly declined, and borrower numbers dropped to 2.66 million in 2023/24. This may be due to regulatory tightening, market saturation, or operational challenges such as the economic impact of the pandemic and increased competition. Despite the decline in institutional count and borrowers, total assets and loan disbursements have remained high or even grown, indicating improved portfolio quality, better risk management, or larger average loan sizes. Overall, the sector has matured, transitioning from rapid expansion to a more stable and consolidated phase, emphasizing sustainability and efficient service delivery rather than mere numerical growth.

VII. CONCLUSION

This study examined the historical development, modalities, regulations, research studies, and growth of microfinance in Nepal. Its evolution has been influenced by cooperative credit schemes, the Small Farmers Development Project, deprived sector lending, and the establishment of Grameen Bikas Banks. Microfinance expanded access to credit, encouraged self-employment, and supported socio-economic development, making it a key driver of inclusive growth in the country. Research on microfinance in Nepal confirms that it has positively affected borrowers' socio-economic status, especially in terms of women's empowerment and small enterprise development. The study also analyzed the growth of Microfinance Financial Institutions (MFIs) from 2016/17 to 2023/24 using secondary data from Nepal Rastra Bank. The sector experienced rapid expansion until 2018/19, with MFIs increasing from 53 to 90, assets rising from Rs. 134 billion to Rs. 273 billion, and borrowers reaching 2.68 million. Borrower outreach peaked at 3.3 million in 2021/22 before a consolidation phase reduced MFIs to 52 and borrowers to 2.66 million in 2023/24. Despite this, assets grew to Rs. 554 billion and loans to Rs. 456 billion, showing strengthened institutional capacity. Overall, Nepal's microfinance sector is transitioning from fast growth to sustainable consolidation.

Interest Conflicts

The authors have no conflict of interest in the research work.

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