
**RURAL FINANCE IN CONFLICT ENVIRONMENTS –
EXPERIENCES FROM NEPAL’S
SMALL-FARMER COOPERATIVES LIMITED (SFCL)**



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Introduction

In recent years much has been published on the subject of microfinance in post-conflict countries. However, very few experiences have been documented with regard to microfinance operations in on-going conflicts. This short paper describes how the Small Farmer Cooperatives Limited (SFCLs) of Nepal have reacted to the conflict in the country. There may be a number of lessons to be learned for other microfinance organisations in conflicts around the world.

Background: The conflict between Maoist rebels and the ruling elites is fought on the poor people's back

After the restoration of multi-party democracy in 1990 the poor in Nepal had big expectations with regard to economic and social development. However, their expectations were mostly not met. The Communist Party of Nepal (Maoist) has capitalized on the wide-spread dissatisfaction caused by bad governance, corruption, and socio-economic and political inequalities.

Since 1996 Nepal is facing a violent conflict between the Nepalese government and the militant Communist Party of Nepal. The so-called Maoists (they are not supported by the Chinese government) aim to abolish monarchy in order to establish a communist republic. They claim to control about 80% of rural Nepal, except the district headquarters and the Kathmandu valley.

The conflict has become increasingly violent: an estimated 12,000 people have already been killed and many more suffered from human rights violations conducted by the Maoists and the government Security Forces. The economic costs of the conflict have recently been calculated by the Asian Development Bank. They conclude "that if development expenditures decline at the current rate (4.2%), the total GDP growth loss is 8.3% for the period between the fiscal years 2005 and 2009, an average loss of 1.7% of growth per annum. If the conflict intensifies and development expenditure

declines at twice the current rate (8.4%), total GDP growth lost is 10.3%, an average loss of 2.1% of growth per annum.”¹

The common people are trapped between the conflicting parties. Especially in rural areas the warring parties press the population for support. As a consequence the number of internally displaced persons increased significantly; many young people have joined the Security Forces or the Maoist army to earn a living; others have migrated to the cities or left the country.

The volume of remittances from overseas workers (mostly in India, Arab countries and Malaysia) has jumped from USD 139 million in the year 2001 to USD 808 million in the year 2004: this is almost 14% of GDP and 55.8% of total foreign currency reserves. Human capital has become Nepal’s number one export. 25% of all Nepalese households receive remittances. However, very poor households are rarely amongst those that benefit.

The History of Small Farmer Cooperatives Limited (SFCL)

The Small Farmer Development Programme (SFDP) was Nepal's first group based poverty alleviation programme, started by the government owned Agricultural Development Bank of Nepal (ADBN) in the mid 1970's - with support of FAO and UNDP. Until 1993 there were 459 Sub Project Offices (SPOs), giving farm credits to 200,000 small farmer households.

However, due to rapid expansion the programme faced several problems: high overhead costs, low repayment rate and lack of competent staff. In 1987, ADBN – with support of the German Technical Cooperation (GTZ) - started to transform SPOs into fully self-administered and managed cooperatives of small farmers i.e. Small Farmer Cooperative Limited (SFCL) which is a multi-service cooperative designed to deliver primarily financial, but also non financial services to its members in rural areas. Small farmer groups are formed as joint liability groups, usually consisting of 5 to 12 members.

Until November 2005, 188 SFCLs have been established. These SFCLs serve approximately 120,000 member households. SFCLs have captured a significant share of the rural financial market. An ADBN/GTZ study showed that from a sample of 33 SFCLs, the average financial self sufficiency ratio had increased from a poor 39% by mid July 1997 to 118% by mid July 2000, putting SFCLs in the category of successful microfinance institutions. Over the last couple of years, however, business climate and the security situation have deteriorated due to the Maoist conflict, adversely affecting the performance of SFCLs.

In order to achieve maximum impact, the GTZ project Rural Finance Nepal (RUFIN) is applying a systemic approach: on the micro level SFCLs are enabled to provide financial and non-financial services; on the meso level, the Small Farmer Development Bank (SFDB) and the SFCL Federations are supported to provide refinance and non financial services for SFCLs. At the macro level interventions are geared towards improving the regulatory and supervisory framework for rural finance.

¹ Measuring the Economic Costs of Conflict, Sungsup Ra and Bipul Singh, Asian Development Bank / Nepal Mission, July 2005

The Conflict has severely affected government-owned rural banks and MFIs whereas community-owned cooperatives have survived fairly well.

The microfinance sector of Nepal is very rural-focused and quite diversified (see table 1 below). The state has a large share in rural microfinance (Rural Development Banks), while there are a number of private Microfinance Banks and a larger cooperative movement. Commercial banks are forced by legislation to lend 3% of their loan portfolio to the deprived sector, i.e. the poor.

Table 1: Key Actors in Nepal's Rural Micro Finance and their outreach (July 2004)

Microfinance Institutions	No. of members	Savings mobilization (million NRS)	Outstanding loans (million NRS)
Eastern Rural Development Banks	48,000	196	509
Central Rural Development Banks	36,000	82	244
Western Rural Development Banks	37,000	83	345
Mid- western Rural Development Banks	14,000	51	137
Far- western Rural Development Banks	11,000	45	116
Nirdhan Utthan Bank (MF Bank)	45,000	80	263
Swabalamban Bank (MF Bank)	26,000	97	194
Deprosc Bank (MF Bank)	10,000	17	89
Chhimek Bank (MF Bank)	9,000	22	75
Small Farmer Cooperative Ltd (SFCL) Total SFCLs: 161 ²	90,000	290	1,317
Savings and Credit Cooperatives (SCC) Total SCC: 2300	180,000	2,500	2,200
Financial Intermediary NGOs Total NGOs: 43	29,000	31	127
Small Farmer Development Project	66,000	43	676
Deprived Sector Lending program of Commercial Banks	76,000	75	289

Source: Website of GTZ-RUFIN Project

² Until November 2005, there were 188 SFCLs with 120,000 members. Even during the conflict situation, the numbers of SFCLs and their members have continuously been growing.

The conflict caused severe problems for the state-owned regional development banks because the Maoists targeted them directly as enemies. There were many cases of lootings and robbery, which forced the banks to withdraw from remote areas and operate only from safe district head-quarters.

The Maoist rebels even attacked most private MFIs and one third of all SFCLs ; moreover, they forced many MFIs to reduce their interest rates and encouraged their clients to stop paying back loans.

Only community based Savings and Credit Cooperatives, informal savings and credit groups (SCGs) and women-managed SFCLs have not been attacked by the rebels.

The reasons behind not attacking women-managed SFCLs are: women are considered more honest towards fulfilling their responsibilities and therefore no bad practices are seen in the co-operatives managed by them; women are much less active in politics than males; women are considered socially excluded groups by the Maoists; and there is cultural taboo against harming women publicly. Overall, based on their

Why Community Based Co-operatives are less affected by the conflict ?

- Co-operatives are owned and managed by the community people themselves. Local people's financial needs are fulfilled by the community based co-operatives. If rebels attack these co-operatives, they will be in threat of losing the community's support.
- Community based co-operatives are more transparent than other financial institutions and their members have contacts with local rebels and security personnel.
- Most of the lower cadres of the Maoist rebels are from socially excluded and disadvantaged groups, similar to the members of community based co-operatives.
- One of the Maoist political objectives is socio-economic development through community owned co-operatives.

communist ideology the Maoist insurgents seem to have a “soft approach” towards those MFIs which they perceive as not-for-profit, people-owned, non-exploitative and not affiliated with the government.

All SFCLs are member-owned cooperatives. However, they originate from a former government development programme and even today they are being refinanced indirectly through the government-owned Agriculture Development Bank. Therefore, local Maoist commanders often perceive SFCLs to be government organisations and attack them merely for this reason.

In other cases financial cooperatives have been attacked after one of the members has lodged a complaint to the local Maoist commander. The complaints are generally about allegedly corrupt cooperative leadership. This has only happened in male-dominated SFCLs. In some cases the allegations may be true in other cases the plaintiffs just acted opportunistically, hoping that they do not have to pay back their loans. In fact the Maoists encourage borrowers not to pay back their loans and most SFCLs which have been attacked or threatened by the Maoists experience an increase in loan defaults. Many SFCLs were also forced by the insurgents to decrease their interest rates on loans.

Members of SFCLs, like most people in rural areas, face many difficulties due to the conflict. The Maoists often impose strikes and curfews on the people, which means that they cannot reach the local market places and thus lose income opportunities. Members and SFCL staff also find it dangerous to travel and to hold cash. Moreover, the Maoists extort taxes from the population and organisations.

MFIs with active members, capable leaders and sound practices can even grow during the conflict.

Despite the bleak situation in Nepal the loan and deposit portfolios of several MFIs and SFCLs remained stable or even grew during the conflict period. One reason for this phenomenon may be that commercial banks have become even more reluctant to lend money in rural areas and focus on urban consumer lending and housing finance only. At the same time, farmers and micro enterprises continued their operations and have demand for financial services.

It appears that the conflict had a “cleansing” effect on the microfinance sector of Nepal. Commercial banks, government MFIs and weak cooperatives have been driven out or further weakened. Some of them have closed down, others have been relocated to safer places (in the district head quarters) and again others have made adjustments to their operations (e.g. no cash transactions, lower interest rates).

Non-government MFIs and SFCLs with active members, capable leaders and sound practices have either not been affected at all or recovered very quickly after an attack. They have recognised the importance of good practices and member ownership

in the context of the conflict. If members really feel that the MFI or cooperative is theirs they will stand up to the conflict parties or re-build their organisation after an attack.

Some MFIs have started to re-educate their members on the principles of microfinance to create a new sense of ownership. Their leaders engage in direct or indirect dialogue with the local Maoist commanders. For example: big signboards have been fixed to several SFCL buildings to inform the public and indirectly also the conflict parties about the cooperative structure and its rules. The SFCLs - through its federations - also published newspaper articles on the purpose and benefits of cooperatives. In one case the SFCL leaders even negotiated with the local Maoist commander a compensation for the damage done to their cooperative building during a rebel attack.

Women play a particularly strong role in the present conflict environment. In Kewalpur SFCL, for example, the leaders of the women-cooperative organised village meetings and educated the people about the meaning of a cooperative. This was a way to let Maoists living amongst the villagers indirectly know about the benefits of the cooperative. The women also engaged in direct dialogue with Maoists after receiving threats and asked them for suggestions of improvement. The Maoists were unable to counter the women's arguments and left them alone.

Promoting good practices, women empowerment and social inclusion will help MFIs to transform internal and external conflicts.

The GTZ-implemented project Rural Finance Nepal (RUFIN) started conflict transformation training for SFCLs in October 2004. Altogether 40 of a total 52 conflict-affected SFCLs have been trained up to date. The training participants identified the weaknesses of their SFCLs and the issues related to the conflict. Then they prepared action plans to deal with these issues. Many SFCL leaders realized that their cooperatives have excluded low caste and landless villagers, which aggravated the conflict in their communities. Another issue identified was the low women participation in

the decision making bodies of mixed-sex SFCLs, which caused male domination and often mismanagement of funds.

The conflict transformation workshops carried one main message: the cooperatives are not helpless victims of the conflict, but they can protect themselves from the conflict and even help solving it. To achieve this, they should ensure their cooperatives work properly and according to their mandate (helping the poor), they should clear up all internal conflicts, empower women to take part in decision making and they should try to better include disadvantaged groups, such as ethnic minorities and low castes. After the training workshops those SFCLs which had been closed due to the conflict resumed operations and the loan repayment rates of affected cooperatives improved very soon. In future, conflict related issues will be integrated in all SFCL training programs.

Internal conflicts are often the starting point for external conflict parties to interfere with the SFCLs. Many internal conflicts are caused by cooperative leaders who try to use the cooperative as a political platform, practice insider lending, default loans, or take decisions without informing the members properly. As soon as the local Maoists get to know about this weakness they will at-

- Good Practices of SFCLs in conflict:**
1. Living the co-operative spirit
 2. Committed and Capable Leaders
 3. Proper Checks and Balances
 4. Active Members
 5. Open membership, Social Inclusion and Women Empowerment
 6. Professional Staff
 7. Sound Financial Management
 8. Voluntary Savings and other client friendly products
 9. Cash-flow and Character based Lending

tack the cooperative or encourage members to stop repaying their loans. Once the repayment moral is eroding it is very difficult to restore it. Therefore, the cooperative leaders have to be positive role models for all members which in turn will ensure that the cooperative cannot be destroyed by outsiders.

The inclusion of disadvantaged groups and women into the cooperative is a different strategy. It tries to address one of the root causes of the Maoist insurgency, inequality and social exclusion. A growing number of SFCLs is managed by women, with very encouraging results: they are better managers and better members than most males. Therefore, the RUFIN project decided that in future they would encourage the

establishment of women SFCLs and increase the women's participation in mixed-sex SFCLs.

The inclusion of socially and politically excluded groups has not been very successful so far, although there are encouraging cases, proving that it is possible, if the cooperative leadership really wants it. The majority of the cooperative leaders are from the higher castes and they consider low castes unreliable members. Low caste people generally belong to the 'poorest of the poor' who have difficulties joining MFIs for many reasons: geographical isolation; inability to join already established groups where there is a requirement to contribute an equivalent amount of accumulated savings; inability to make compulsory regular savings; illiteracy; fear of going into debt and being further stigmatised; lack of collateral (such as land or citizenship certificates).

Cooperative Federations help their members to cope with the conflict.

SFCL federations on district level provide non-financial services to their member cooperatives (e.g. training and bulk purchasing of stationery). During the conflict period the federations can also play the role of mediator or guardian of SFCLs. Individual SFCLs backed by their federation feel empowered to deal with a conflict situation. The Dhading District Federation, for example, had organized a press conference in Kathmandu to disseminate a message to the Maoist insurgents that the ownership of SFCLs was with community people and that SFCLs are providing services needed by small farmers. The federation also provided financial and moral support to revitalize those SFCLs which were affected by the conflict situation.

Outlook: Building capacities for good Performance and raising conflict sensitivity of SFCLs.

Based on the lessons learned GTZ-RUFIN will focus on two aspects in future: building capacities of SFCLs and their federations, and raising conflict sensitivity amongst their leaders and members in order to enable them to provide efficient and effective services in a conflict sensitive manner. What does this actually mean?

Building capacity for good financial and operational performance is nothing new to microfinance practitioners. It entails training and advice on issues such as e.g. loan appraisal, product development, accounting, internal controls, business planning etc. In the case of SFCLs cooperative-specific capacities are also needed: members must learn to actively control their leaders through the annual general assembly; leaders must learn that they are accountable to their members; cooperative managers must learn how to run their operations like businesses.

Raising conflict sensitivity is a subtle and fickle process in a country where people prefer to be silent about conflicts. Therefore GTZ-RUFIN will include conflict sensitivity as an issue in “normal” training or advisory services. Leadership training will include techniques how to manage internal conflicts and how to behave towards external aggressors. Business planning training for SFCL managers will also cover aspects of corporate social responsibility, stressing the importance of addressing conflict root causes through women empowerment and social inclusion.

The vision of GTZ-RUFIN is to create a vibrant, healthy and business-driven SFCL movement which does not neglect its social responsibility. Thus SFCLs will actively contribute to transforming the conflict and hopefully one day to build peace.

Acronyms

ADBN	Agriculture Development Bank of Nepal
GDP	Gross Domestic Product
GTZ	German Technical Co-operation
MFI	Micro Finance Institution
NRS	Nepal Rupees
RUFIN	Rural Finance Nepal
SCC	Savings and Credit Co-operative
SFCL	Small Farmer Co-operative Limited
SFDP	Small Farmer Development Programme
SPO	Sub-Project Office
USD	United States of America Dollar