Microfinance in Nepal:

General Background

- Population: 28.8 mn
- Main towns: Kathmandu (0.67m), Biratnagar (0.17m), Birgunj (0.11)
- Currency: Nepalese Rupee Rs or NPR
- Exchange rate: 1 USD = 74.25 NPR (2009-10)
- Fiscal Year: 16th July – 15th July
- **Development Indicators:**
  - Population below poverty line (National): 31% (2008)
  - GNI per capital (Atlas method, USD): 400
  - Literacy Rate (15-24 years) : 56.5% (2007)
  - Mortality Rate (child<5 years): 51 per 1000 live births (2008)
  - Life expectancy at birth: 67 years (2008)
  - HDI: 0.553,144 among 182 countries in HDR 2009

Historical Evolution

Indicator	2009-10
Nominal GDP (USD bn)	15.63
Real GDP Growth (%)	4.0
Consumer Price Inflation (avg, %)	8.0
Exchange rate (avg vs USD)	74.25
External Debt (as a % of GDP)	23.8
FDI (USD mn)	37.6

Until the 1980s, the microfinance sector was served by cooperative (1950-60s) and nationalized banks (1970s-1980s) without much success. During the 1980s-90s, a number of pilot projects and initiatives were implemented such as the Small Farmers Development Project (SFDP) in the 1980s, the Microcredit Project for Women in 1994 with assistance from the Asian Development Bank (ADB), the Intensive Banking Program targeted at the poor and the Production Credit for Rural Women project that was launched through two national commercial banks and Agriculture Development Bank of Nepal (ADBN) exclusively to focus on women.

These programs reached a certain level of outreach but could not provide a sustainable model to provide financial services for the poor.

Following this, some encouraging developments in the 1990s that matured in the 2000s, laid the foundation of the microfinance sector in Nepal, as we know it today. Among them was the formation of five Regional Development Banks (RDBs) by the government in five regions during 1992-96 based on the Grameen model with the objective of providing micro-credit services to the poor. While RRBs failed due to bad portfolio quality, high staff costs, lack of supervision and monitoring and professional management and eventually privatized, they later transformed to became Microfinance Development Banks (MFDBs) as class ‘D’ financial companies.

In the late 1990s, a number of NGOs and private microfinance banks also started microfinance programs in the country. Following the Grameen Bank model, in 1993-94, NGOs such as Nirdhan and Centre for Self-help Development (CDF) successfully implemented microfinance programs and later transformed into MFDBs. In the early-2000s, three private microfinance development banks; Chhimek Bikas Bank Ltd. (CBB), Deprosc Bikas Bank (DBB) and Nerude Microfinance Development Bank Ltd. (NMDB), were also established.

During same period, in early 2000, NGOs involved in community based financial activities were given legal recognition and licensed by the central bank, NRB to provide a conducive policy environment to formalize micro financing services. As a result, there are 45 Financial Intermediary NGOs (FINGOs).

Development during this phase was greatly supported by the establishment of a number of wholesale funding institutions beginning with the Rural Self-Reliance Fund (RSRF) within NRB in 1991 to provide financial support to NGOs and cooperatives, the Rural Microfinance Development Centre (RMDC) in 1998 under public private partnership with NRB having a 26% stake with the remaining owned by 13 commercial bank , the Sana Kisan Bikas Bank Limited (SKBBL) in 2001 with a mandate to finance Small Farmer Cooperatives Ltd (SFCLs) and the National Cooperative Development Bank (NCDB) in 2003 with to finance cooperatives in the country.

Presently, microfinance services are provided by Microfinance Institutions (MFIs) working as regulated MFDBs, FINGOs, Savings and Credit Cooperatives (SACCOs) and SFCL. While the first two are regulated by NRB, SACCOs and SFCL are governed by cooperative laws.

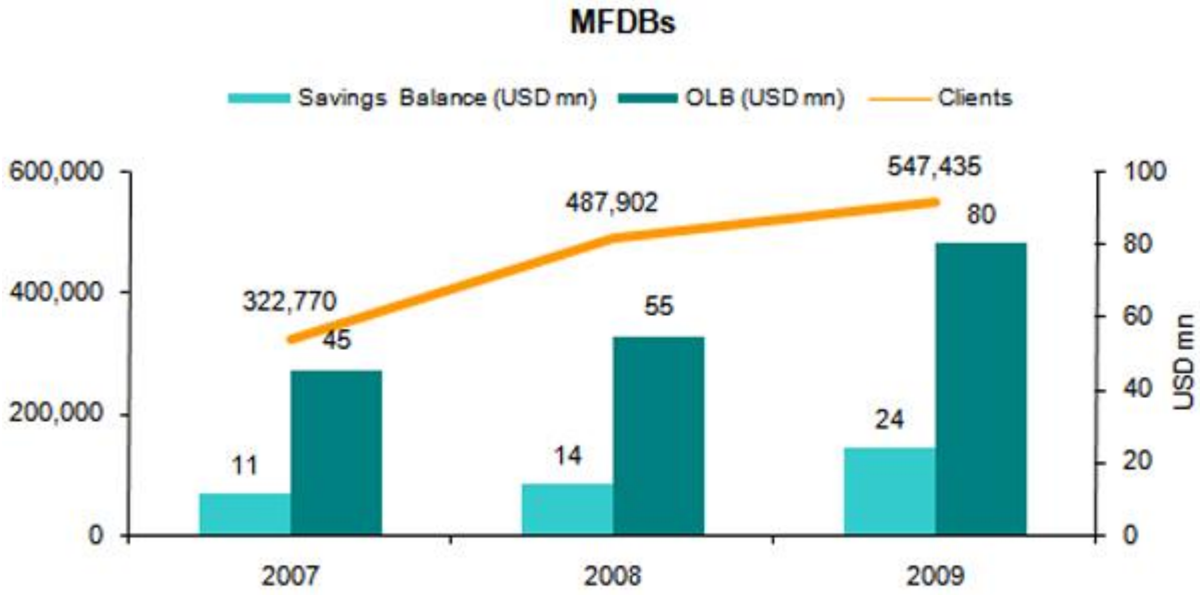
Based on the available data on borrowers served, the top 20 MFIs (among sixty major MFIs) cover 89.4% of borrowers, 96% of the total disbursement and 93% of the outstanding loans. Nirdhan Utthan Bank Ltd is the largest MFI with maximum borrowers followed by the Chhimek Bikas Bank Ltd and Swabalamban Bikas Bank Ltd as second and third largest respectively. The Government RDBs has 25% of the total borrowers of the top twenty MFIs, while the share of the private MFDBs is 42%, of FINGOs 26% and of Cooperatives 7%.

Types of MFIs

Three key microfinance providers can be classified as follows:

Microfinance Development Banks (MFDBs): Among these, there are five Grameen VIkas Banks and eight private sector Grameen Bank replicas.

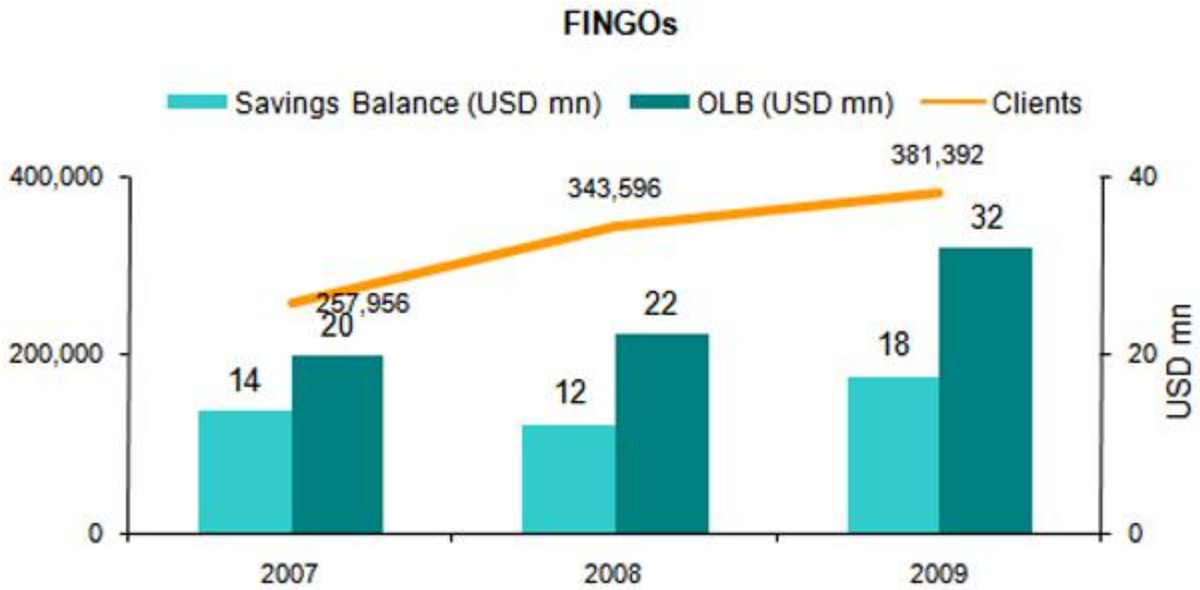
- Grameen Bikas Bank: They provide micro-finance services to rural poor women under group guarantee without collateral. The government owned bur recently four out of five GBBs are privatized.
- Private Microfinance Development Bank (PMFDBs): Eight of the Grameen Bank replicas established by the private sector include Nirdhan Utthan Bank Limited, Chhimek Bikas Bank Limited, Swabalamban Bikas Bank Ltd, Deprosc Bikas Bank Limited, Nerude Bittiya Sanstha Limited, Naya Nepal Laghu Bitta Bikas Bank Limited, Mithila Laghu Bitta Bikas Bank Limited and Summit Micro Finance Development Bank Limited.



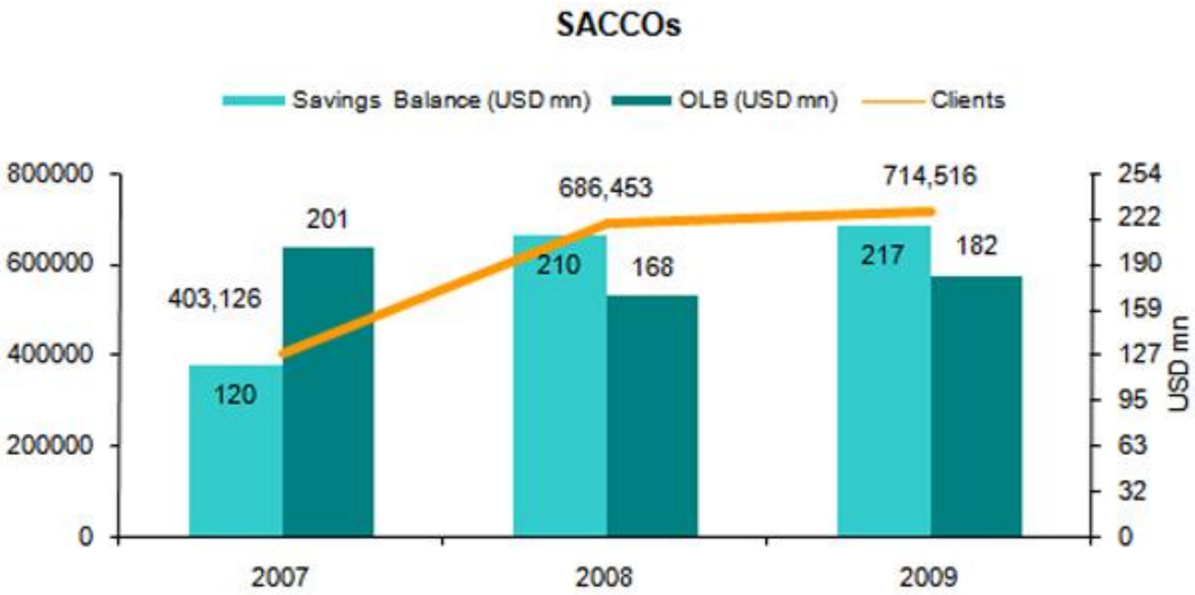
Together MFDBs they reach 547,435 clients with Rs 1,766 mn (USD 24 mn) in savings and Rs 5,992 mn (USD 81 mn) in OLB end July 2009.

MFDBs are financed by RMDC along with commercial banks and finance companies under the Deprived Sector Lending (DSL) scheme.

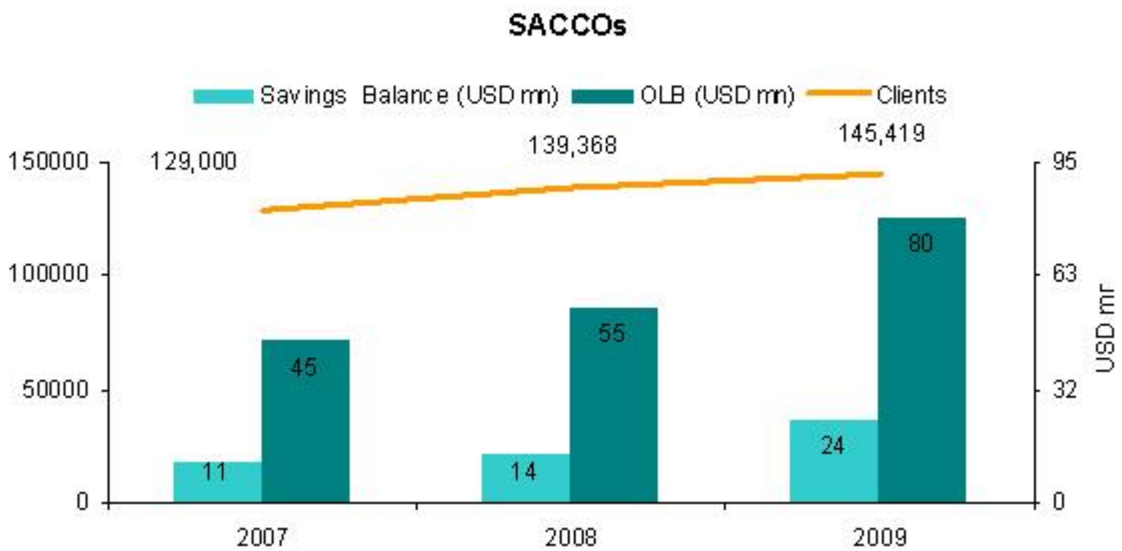
FINGOs: There are altogether 45 FINGOs licensed by NRB to undertake limited financial transactions. These are registered under Institutions Registration Act 1977 and undertake limited banking transactions in accordance with the provision of the Financial Intermediation Related Institutions Act 1999. As per the figures available for mid July 2009, they reach 381,392 clients in 38 districts with a coverage of 64% hill districts and 36% Terai districts. Most FINGOs normally serve between 2,000 – 30,000 clients.



Cooperative: They can be classified into two subgroups:



- Savings and Credit Co-operative (SACCOs): There are 5,161 SACCOs reaching 714,516 individuals in 72 districts as of mid-July 2009. They normally serve 50-200 members and are governed by cooperative laws. On average there are 3 staff members working in each SFCL. SACCOs are not well regulated and supervised; as a result, many of them do not have standard accounting and sound management practices and lack good governance. In spite of all this, SACCOs are considered more suitable models for the hills and mountains as they provide both savings and financial services to the members who are local people without much bureaucratic process. In addition to member's savings, SKBBL is main source of financing to SACCO at 9.5%.



- Small Farmers Cooperative Limited (SFCL): SFCL is a member-managed multi-service cooperative designed to deliver primarily financial as well as non-financial services to its members in rural areas. By mid July 2009, 225 SFCLs reached 145,419 individuals in 40 districts of the country. The SFCL is generally confined to one Village Development Council (VDC) area and targets only small farmers. Each SFCL on average serves around 500 households catering to 200-700 clients in a community.

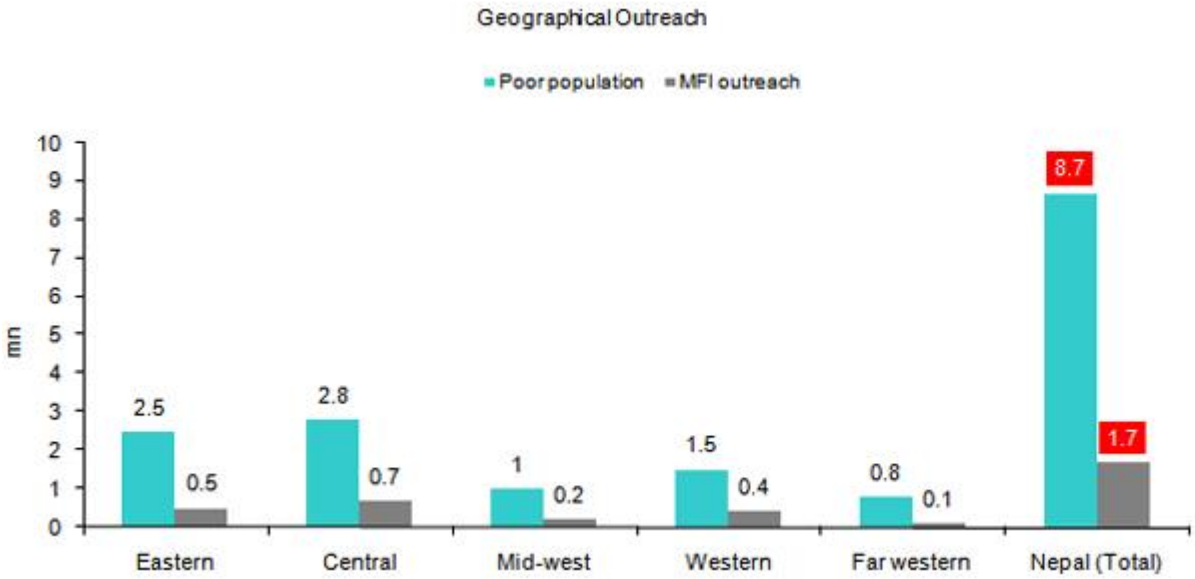
SKBBL provides them with wholesale loans while the federation of SFCLs regularizes and supervises their financial activities. Federations of SFCLs also provide non-financial i.e. social mobilization, trainings and technical support services.

Major highlights of the sector

Outreach

The microfinance sector as of mid July 2009 reached over 1.7 mn people.

Microfinance Outreach as of July 2009 MFI Type	Number	Members	Savings USD mn	OLB USD mn
Microfinance Development Banks (MFDBs)	13	547,435	24	80
Financial Intermediary Non Government Orgnization (FINGOs)	45	381,392	18	32
Small Farmer Cooperative Ltd (SFCL)	25	145,419	17	31
Savings and Credit Cooperatives (SCC)	5,161	714,516	217	182
Total	**5,244**	**1,788,762**	**275**	**324**



While the Terai region is largely well served by MFIs, the remote and mountainous regions continue to lack microfinance services. MFDBs largely operate in the Tarai, whereas FINGOs and cooperatives are the largest service providers in the hills and mountains.

Growth

The microfinance sector in Nepal has grown at a fast pace in recent years though growth rates vary among different types of MFIs. In the last three years, MFDBs have grown at a much faster pace. However, last year’s growth slowed down both in number of borrowers, savings and OLB on account of various factors including high inflation, contraction in savings and negative perception among others.

Microfinance Growth (%')			
	Clients	Savings	OLB
MFBs 2008 2009	51 12	24 69	21 46
FINGOs 2008 2009	33 11	-11 44	12 44
SACCOs 2008 2009	70 4	76 3	0 0
SFCLs 2008 2009	8 4	24 69	21 46

Products

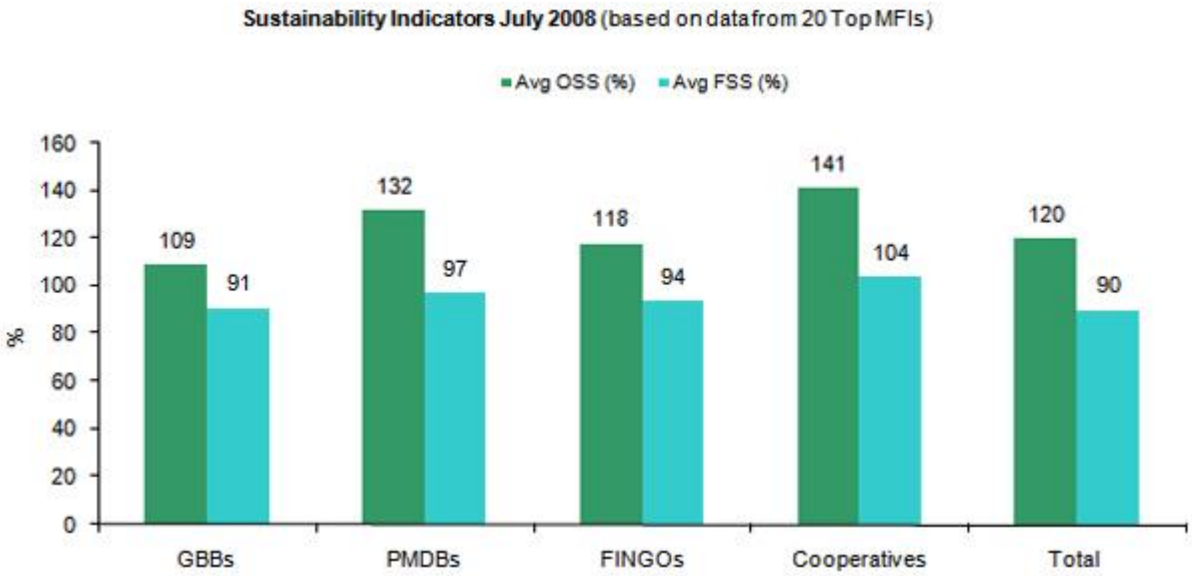
In Nepal, MFIs are allowed to mobilize savings only from their members/clients. They cannot accept deposits from the general public. Most MFIs offer mandatory and voluntary saving schemes. Under mandatory savings the clients need to deposit a certain amount in their regular meetings and a certain percentage of loan amounts (ranging from 3 to 5%) is also deducted and deposited in the same account. Under voluntary savings, the clients can deposit any amount they want. The MFIs in Nepal have been providing interest rates on saving deposits of their members ranging from 5% to 8% per annum. Interest is capitalized in every 6 months (January and July) during bi-annual closing of their transactions. Some MFIs have introduced other savings schemes like pension funds, child education funds, etc. and have given interest of up to 10% per annum. It is important to note that the saving balances finance about one third of the loan portfolio of MFIs.

MFDBs and FINGOs use the Grameen model. MFIs serve clients for small loans generally below Rs 50,000 (USD 673) though NRB defines microfinance loans as below Rs 150,000 (USD 2020) for MFDBS. Most provide short-term loans of less than 18 months for productive uses such as agriculture, livestock, poultry, petty trading and grocery stores. MFIs have complete freedom to fix interest rates. However, the NRB Act 2002, in case of the Rural Self- Reliance Fund (RSRF) has specified the interest rates for its borrower cooperatives and NGOs, which are far below the market rates. This has to some extent distorted the market interest rates. The PMFDBs charge between 20% - 25%; the government owned GBBs charge a 20% interest rate per annum on the loans to their clients; SFCLs charge an interest rate of 13% per annum; some FI-NGOs are charging as low as 18% per annum (Deprosc), while others are charging interest between 20 to 25% per annum. Initially most of the MFIs charged interest on a flat basis but now more and more MFI are charging on a declining balance basis.

A few microfinance banks and cooperatives now offer remittance transfer service products. Due to the lack of insurance services available in rural areas, most MFIs have offered some institution-based protection schemes related to livestock death and life insurance. In partnership with Western Union Money Transfer (Annapurna travels and tours), Samsara private.

Sustainability

Following the failure of many subsidy-oriented government microfinance programs and projects, the present set of MFIs in the country including those which are state owned, have a key objective to provide microfinance services to the poor in a sustainable manner without subsidy or grant supports.



The sector wide data for key sustainability indicator is not available. However, the Institute of Microfinance (InM) Study of the Nepal microfinance sector in 2009 provides information through data collected from the top twenty MFIs on Operational Self-Sufficiency (OSS) and Financial Self-Sufficiency (FSS).

Meso level infrastructure

Each four categories of MFIs have their separate associations as networks.

MFDBs have a network association called Nepal Microfinance Bank Alliance (NMBA), FINGOs have Microfinance Association of Nepal (MIFA) and SACCOs have Nepal Federation of Savings and Credit Cooperatives Union Ltd (NEFSCUN). SFCLs has recently formed an association under the name of Agriculture Cooperative Bank to function as network of SFCLs.

Centre for Microfinance (CMF) is providing valuable technical assistance (TA) services to the sector as a whole. CMF is expanding its role from TA provider to become the National Network for all the microfinance providers in the country in coming years and take policy advocacy roles.

There are no Rating Agencies and Credit Information Bureau catering to microfinance sector in Nepal.

Competition

According to InM Study on Microfinance Sector in Nepal, the top 20 MFIs are facing problems of overlapping clients as they all are more concentrated in densely populated areas. According to this study, enrollment of clients in more than one MFI is a common practice in many areas. This factor has now started affecting outreach, disbursement and repayment of all concerned MFIs. There is no specific study on multiple borrowings; however, the MFIs reported that multiple borrowing is about 20-40%.

Risks

Externally, the high inflation has an impact on microfinance sector as inflation affects the saving capacity of the clients and thus financing structure of MFIs. During last years, many MFIs have seen drop in savings due to high inflation.

Another key risk to the sector is regulation and governance issues for much of the sector. A large number of cooperatives remained outside of effective regulations and supervision and have serious problems with governance and management.

Regulations

Presently the central bank, the NRB is supervising MFDBs and FINGOs. Cooperatives do not fall in the regulatory and supervisory responsibility of NRB. The Department of Cooperatives under the Ministry of Agriculture and Cooperatives is the regulatory body for the Cooperative Societies including Savings and Credit Cooperatives registered under the Cooperative Act 1992. Laws and Regulations that govern MFIs are as following:

- Nepal Rastra Bank Act, 2002
- Bank and Financial Institutions Act, 2006
- Cooperative Societies Act, 1992
- Financial Intermediary Act, 1998
- NRB Directives for Banks and Financial Institutions, 2010

MFDBs are categorized as ‘D’ type financial institutions under BAFIA and the prudential norms are designed in line with normal financial institutions except that paid-up capital requirements are lower. Out of their paid up capital at least 30% should be sold to the general public. As per article 47 sub-article (7) (j) of the Bank and Financial Institution Act, 2006, the class “D” microfinance development banks can collect and pay back savings with interest or without interest subject to limits prescribed by the NRB.

The Financial Intermediary Act is designed to accommodate non-government organizations under regulation and 45 financial NGOs are licensed under the Act. The supervision of FINGOs, by NRB is quite week and the NRB has not taken any action for non-submission of reports or non-compliance of regulations. Any NGO willing to operate a microfinance program has to get a license for financial intermediation from the central bank. However, before getting a license of microfinance operation from NRB, an NGO has to be registered with the respective District Administration Office.

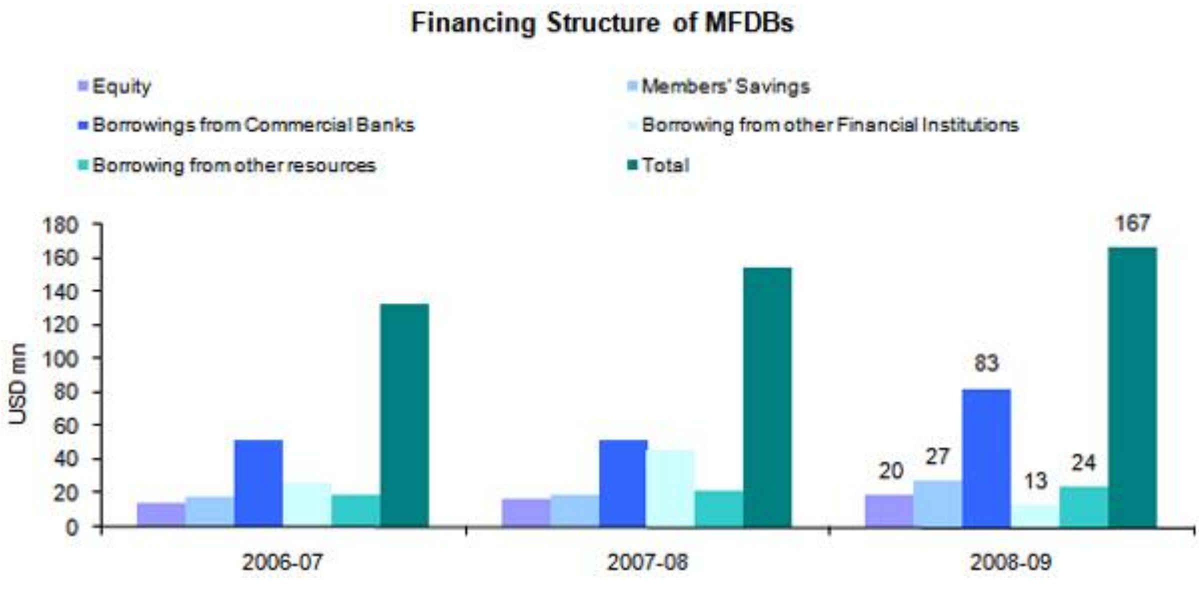
Cooperative do not come under the regulatory framework of the NRB. Department of Cooperative regulates SFCLs and SACCOs under Cooperative Act 1992. However, some cooperatives that have been licensed from NRB for limited banking services and these come under its regulation and supervision. FINGOS and SACCOS are allowed to work in one district at the beginning and later their working districts are added after complying with the directives from NRB. They must maintain positive net worth.

In view of increasing demand for microcredit and its critical role in poverty reduction in the country, the Government of Nepal issued a 'National Microcredit Policy, 2007' with an aim to create a conducive financial infrastructure and legal environment for the promotion and development of the microfinance industry and to use microfinance as a tool for poverty reduction in the country. The specific objectives of the policy are: (i) increasing the outreach of microfinance services to women and families from low income groups, (ii) simplifying and increasing access to quality microfinance services for the target group, (iii) strengthening institutional capacities of microfinance service providers, (iv) formulation of necessary microfinance laws, and (v) development of appropriate institutional infrastructures for maintaining financial discipline and accountability in the whole industry.

However NRB has recently drafted an act to establish a Nepal Microfinance Authority for this purpose, but it has not been forwarded to the parliament for the approval. As per this new act, the MFDBs, FINGOs and Cooperatives would come under the supervision of the new Regulatory Authority created for this purpose.

Financing

From the financing mix of these MFIs, borrowing is the most critical component of financing. It covers about 76% of total resource mobilization. The members savings comes next followed by equity.



As per latest data, the financing structure of MFDBs and FINGO has, borrowings:74.5%; saving:17.4% ; institutional capital:8.1%. For SACCOs and SFCLs, borrowings:20%, Saving:77%, and institutional capital:3%.

The study of partner MFIs of RMDC revealed MFIs were able to raise 38% of the fund from members Savings, about 30% RMDC and rest from the commercial banks and their equity .

Savings: According to data from the main MFIs, the saving to loan ratio in these institutions varies from 27.18% to 71.05% and approximately one third of lending requirement is met through savings.

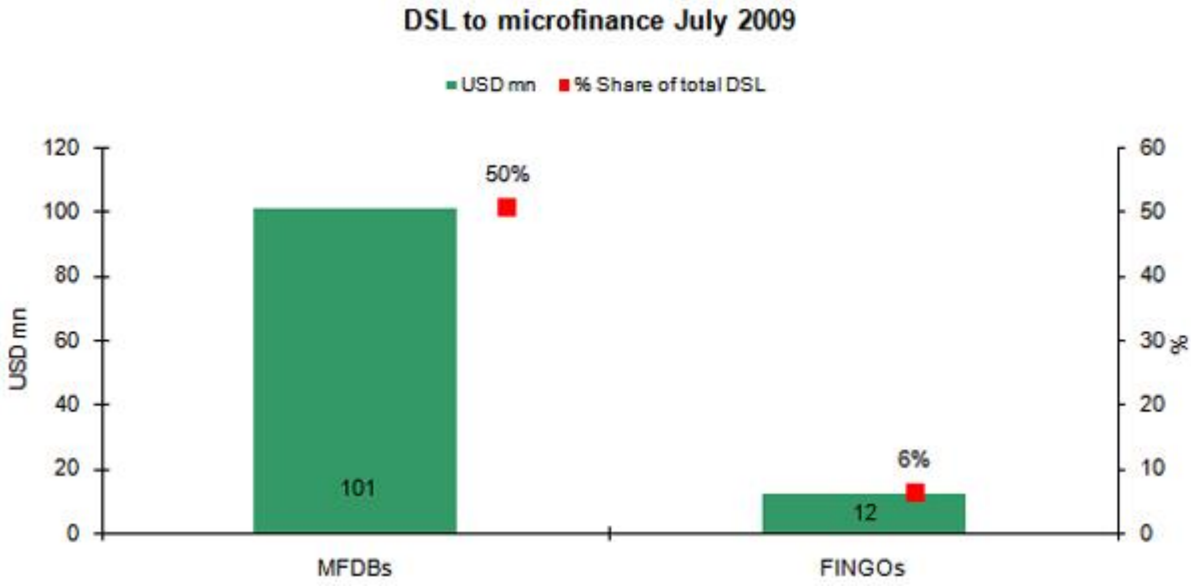
Borrowing: Rural Microfinance Development Centre Ltd. (RMDC), Sana Kisan Bikas Bank Ltd. (SKBBL) and Nepal Rastra Bank- Rural Self Reliance Fund (RSRF) are the major sources of wholesale funding to MFIs in Nepal. In addition commercial bank and financial institutions lend to microfinance providers under DSL scheme.

Loans by Apex Funding Institutions				
	Partner MFIs	Disbursed (USD mn)	OLB (USD mn)	As on
RMDC	80	51.11	21.63	March 2010
SKBBL	232	75.43	14.88	April 2010
RSRF	305	2.60	1.20	July 2008
Source: RMDC, SKBBL and NRB website				

RMDC: Since the establishment of the Rural Microfinance Development Center Ltd. (RMDC) in 1998 (which started its operations in January 2000), the number of partner MFIs increased steadily from eight in July 1999 to 60 in July 2008 and to 86 by June 2010 (7 MFDBs, 9 Development Bank, 46 SCCS, 24 FINGOs). RMDC provides wholesale loans at 6% interest per annum for general loans and at 5% per annum for livestock loans under the Community Livestock Development Project. Over 75% of loans are disbursed to MFDBs and FINGOs.

SKBBL: This is a specialized wholesale microfinance development bank established with the aim of promoting and strengthening grassroots level Small Farmer Cooperatives Ltd. (SFCLs) in particular and similar other microfinance intermediaries in general. It charges an interest rate of 9.5% per annum.

RSRF: The government of Nepal established RSRF in 1991. RSRF lends to SFCLs, Cooperatives and FINGOs at the interest rate of 8.0%, however, 7% of the interest rate charged by the RSRF is paid back to the respective institution for its development if the borrowing institutions repay the principal and interest in a timely manner. Thus, the net interest rate stands at only 2%. This has distorted the market rate to some extent. The ceiling of credit to the SACCOs and NGOs is 10 times or their total savings/ or share capital or a maximum of Rs 1 mn which ever is lower. Only four FINGOs have received credit funds from RSRF out of total 334 recipient institutions by mid-July 2008 .



Another important source of financing for MFIs is Commercial Banks. They provide wholesale funding to MFIs under the DSL Scheme. As per NRB directives, DSL mandatory lending obliges commercial banks (class "A" financial institutions) to lend at least 3% of their portfolio to the deprived sector, while class "B" development banks and class "C" finance companies are obliged to lend 1.5% to the deprived sector. They can either lend directly small loans to clients, lend to MFIs or invest in the equity of such MFIs. A penalty equal to the highest interest rate charged on loans is to be imposed on any of the banks that do not meet the prescribed requirements. The commercial banks charge 3-6% interest per annum on wholesale loans to MFIs depending on the urgency of their disbursement to meet the 3% deprived sector lending requirement. They extend loans to MFIs generally for one year and further extension or renewal is made for another one year after the expiry of each loan. However, currently banks have revised their deprive sector lending rate to 6-9%) which is the very higher rate for the MFIs.As of July 2009, total funding available under DSL is USD 199 mn of which 50% is channeled to class "D" microfinance development banks.

<u>Tier II MFIs</u>

According to the Centre for Microfinance (CMF), the nodal point for microfinance sector in Nepal, MFIs below 50,000 active borrowers can be classified as Tier II in Nepal. By this defintion, 53 MFIs among 45 FINGOS and 13 MFDBs, can be classified as Tier II. The cooperatives can be classified as Tier III.

<u>Market Gaps and Challenges</u>

Despite the vibrant microfinance sector in Nepal, there is still a scarcity of MFIs. Total rural credit requirement in the country is estimated at Rs 23.3 bn (USD 313 mn), while the total supply from the formal and semi-formal sectors is only Rs 9.6 bn (USD 129 mn). Of the approximate 2.1 mn households living below the national poverty line, nearly half are deprived of services from the formal microfinance sector.

Further, there are financing gaps as well. According to estimates, during 2009-10, there were significant funding gaps to meet the funding needs of MFIs.

In terms of institutional capacity, Cooperatives, often lack focus and institutional capacity. Most FINGOs are also at a nascent stage of development, with weak systems, leadership, staff capacity and organizational culture and structure. Most of the FINGOs and cooperatives do not have adequate capacity and sufficient equity capital to borrow funds from commercial sources. The growth of microfinance in Nepal is therefore constrained by the limited number of capable microfinance providers and limited capability of the public-owned MFDBs.

Key Contacts

- **Centre for Microfinance (CMF)**
  http://www.cmfnepal.org/

- **Nepal Rashtirya Bank (NRB)**
  http://www.nrb.org.np/

- **Rural Microfinance Development Centre (RMDC)**
  http://www.rmdcnepal.com/front/index.php

- **Sana Kisan Bikas Bank Limited (SKBBL)**
  http://www.skbbl.com.np/