Making Access Possible

Nepal

Detailed Country Report

2016

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Making Access Possible (MAP) is a multi-country initiative to support financial inclusion through a process of evidence-based country diagnostic and stakeholder dialogue, leading to the development of national financial inclusion roadmaps that identify key drivers of financial inclusion and recommended action. Through its design, MAP seeks to strengthen and focus the domestic development dialogue on financial inclusion. The global project seeks to engage with various other international platforms and entities impacting on financial inclusion, using the evidence gathered at the country level. The MAP methodology and process have been developed jointly by UNCDF, FinMark Trust (FMT) and the Centre for Financial Regulation and Inclusion (Cenfri) to foster inclusive financial sector growth. At country level, the core MAP partners collaborate with government, other key stakeholders and donors to ensure an inclusive, holistic process.

Nepal-Denmark Development Cooperation
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The cover symbol

Through the MAP programme, we hope to effect real change at country level and see the impact of financial inclusion on broader national growth and development. The cover graphic features the Rhododendron, a flower synonymous with Nepal. The flower symbolises growth and development while the circle represents inclusive growth. Each flower is an example of the successful growth in a unique environment. By combining the flower with the currency symbol of Nepal we represent the characteristics of the country, linking financial inclusion with successful growth.

ABOUT MAP NEPAL

MAP Nepal is managed under the overall UNNATI-A2F (Access to Finance) programme implemented by Nepal Rastra Bank (NRB – the Central Bank of Nepal) and funded by the Government of Denmark, DFID and UNCDF in partnership with the United Nations Development Programme (UNDP). This Nepal financial inclusion country report serves to summarise a series of documents produced as part of the Making Access Possible (MAP) Nepal initiative. Preparation for MAP Nepal was approved by the Central Bank of Nepal and the Ministry of Finance. The project is governed by a Project Executive Board chaired by the Central Bank of Nepal and consisting of eight members representing government and project sponsors.

Note on the use of the FinScope Survey 2014: Within this document (unless otherwise referenced), demographic, income and financial usage data is obtained from the 2014 FinScope Consumer Survey. A summary report and presentation of FinScope Nepal is available as a separate deliverable, and the FinScope dataset is available on request for future research at map.uncdf.org.

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Abbreviations and acronyms

ADB	Asian Development Bank
AML/CFT	anti-money laundering and combating the financing of terrorism
ATM	automated teller machine
Avg	average
BFI	banks and financial institutions
CIT	Citizen Investment Trust
CSD	Central Securities Depository
DoC	Department of Cooperatives
EFT	electronic fund transfer
EPF	Employees Provident Fund
FI	financial inclusion
FINGO	financial intermediary non-governmental organisation
FSP	financial service provider
FY	financial year
GBB	Grameen Bikas Bank
GDP	gross domestic product
HDI	human development index
ID	identity document
IRD	Inland Revenue Department
KYC	know your customer
Ltd	Limited
JV	joint venture
MAP	Making Access Possible
MFI	microfinance institution
MFSP	mobile financial service provider
MIP/VIP	mapped Internet protocol/virtual Internet protocol
MoF	Ministry of Finance
MSME	micro, small and medium enterprise
MTO	money transfer operator
MW	megawatt
NCH	Nepal Clearing House
NEPS	Nepal Electronic Payment Systems
NEPSE	Nepal Stock Exchange
NGO	non-governmental organisation
NPL	non-performing loan
NPN	Networking Professionals of Nepal
NPR	Nepali Rupee
NPS	National Payments System
NRB	Nepal Rastra Bank
NTA	Nepal Telecommunications Authority
PIN	personal identification number
POS	point of sale
RoE	return on equity
Rs	Indian Rupee
RSRF	Rural Self Reliance Fund
RTGS	real time gross settlement
SACCO	saving and cooperative society/financial cooperative
SCT	Smart Choice Technologies
SEBON	Securities Exchange Board of Nepal
US$	United States Dollar
vs	versus

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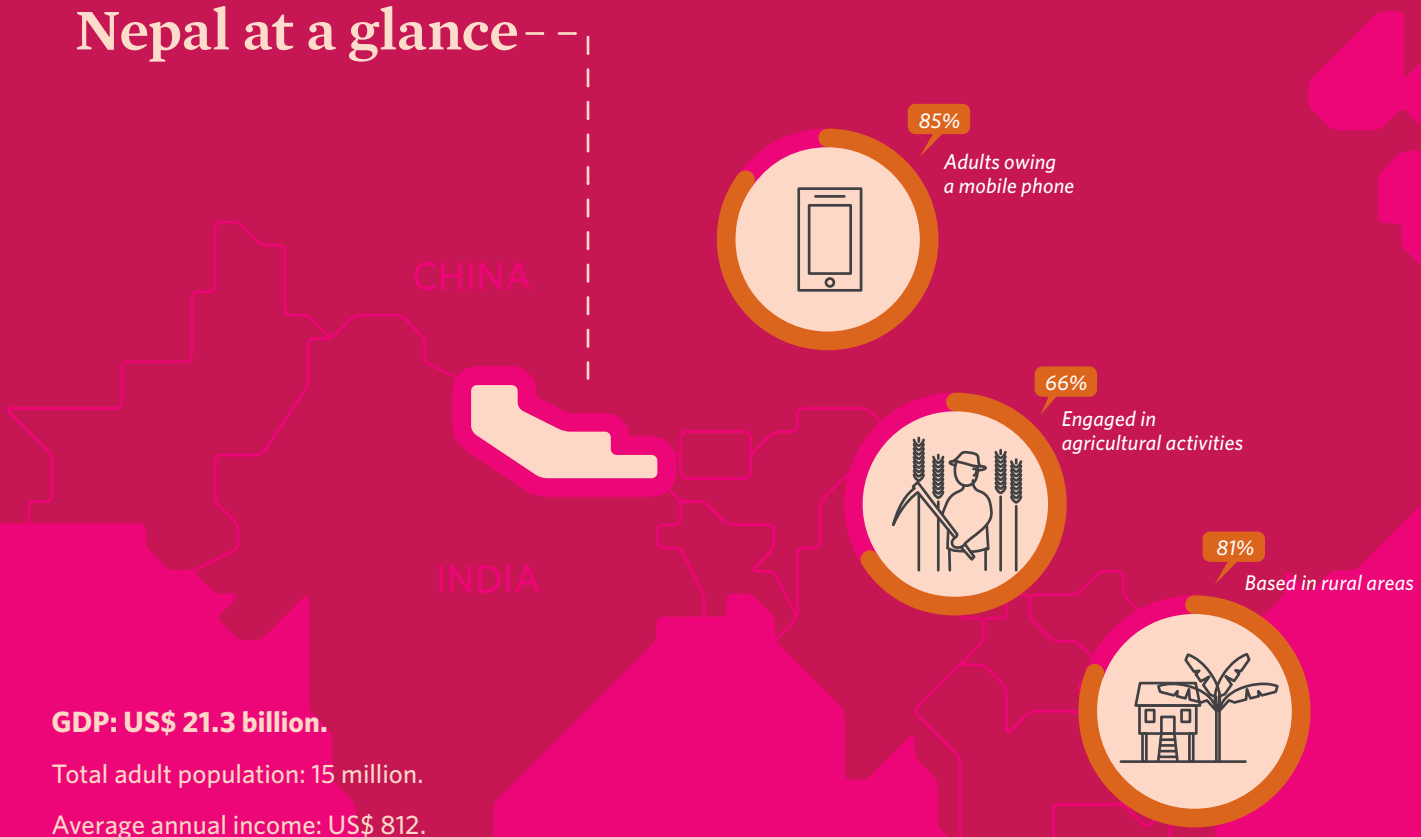
Nepal at a glance



GDP: US$ 21.3 billion.

Total adult population: 15 million.

Average annual income: US$ 812.

Percentage of adult population engaged in agricultural activities in some form: 77%.

Percentage of population based in rural areas: 81%.

Percentage of adults owing a mobile phone: 85%.

Contribution of remittance to national GDP: 28%.

Contribution of informal sector to GDP: 38%.

Percentage of adult population living below international poverty line: 25%.

US$/NPR Currency Exchange Rate

The local currency in Nepal is the Nepali Rupee (NPR). The United States Dollar (US$) equivalents shown throughout the document were calculated using a 12-month average exchange rate (between 16 July 2013 and 15 July 2014, as per Nepal's fiscal year calendar) of NPR 98.53/US$.

Introduction

Methodology and process

The MAP research methodology takes a holistic view of a country, combining the complex interplay of political economy, the driving customer needs and the market context. In order to do this, comprehensive interviews are undertaken with key stakeholders ranging from government to donors, associations and private sector entities. The data from these interviews is then overlaid with the following data tools to provide further guidance.

Segmenting the target market

In order to better understand and unpack demand-side behaviour, assess the nature of financial services uptake and identify key priority areas for future extension of financial inclusion, it is necessary to segment the adult population into distinct groups (rather than assuming a single, homogeneous target market). This makes it possible to get a fine-grained understanding of the different target market groups' unique characteristics, behaviour and varying needs, as well as the significant constraints they face with regard to financial inclusion. This more nuanced understanding can then inform differentiated policies and interventions that effectively target the specific needs of each different segment of the population. MAP is finding that across the countries in which it conducts research, broadly similar demographic profiles are emerging.

The six target market groups that form the basis of the discussion in this report were determined based on the main individual income source as reported by FinScope (2014), and also take into account geographical, demographic and other parameters. Main income source is used as a proxy for the level and regularity of income, both of which are key predictors of whether a person would be a viable financial service client. The intention is to create clusters of people who are sufficiently different from other groups and yet have sufficient shared characteristics to form a common target market for financial institutions. FinScope 2014 survey data was used to profile each of the segments and assess their current interaction with financial services and potential needs.

In this report the target market segments form the basis for assessing gaps and opportunities in the four product markets: payments, savings, credit and insurance.

The FinScope access strand explained

FinScope uses the financial access strand to enable comparison of levels of financial inclusion across countries or market segments. The explanation below applies to FinScope in the context of the MAP Nepal diagnostic exercise (2014).

In calculating the access strand, a hierarchical approach is used in order to depict:

- **Banked:** The percentage of adults who have/use financial products and/or services provided by class A, B, C or D banks regulated by the central bank under the Bank and Financial Institution Act 2063 (2006). This is not necessarily exclusive usage – these individuals could also be using financial products from other formal financial institutions, or informal products.
    - On the basis of the functional categorisation of banks in Nepal, this study further classifies 'banked' into two categories:
        - Category 1 – includes class A, B and C banks.
        - Category 2 – includes class D banks.

- **Other formal:** The percentage of adults that use financial products from non-bank formal financial institutions, but do not have bank access for these products. These individuals could also be using informal products.

The banked and other formal segments together form the *formally included* population.

- **Informal:** The percentage of adults not formally served, but that use informal financial products or mechanisms. This is *exclusive* informal usage and does not include individuals who are within the banked or 'other formal' categories of the access strand that also use informal services.

- **Excluded:** The percentage of adults that do not use any financial products – formal or informal – to manage their financial lives.

The access strand does not show overlaps between the various categories. Consequently, the 'other formal' or 'informal only' segments do not indicate total usage of non-bank formal or informal financial services, but only indicate those individuals who use a non-bank financial service but not a bank account, or an informal financial service but no formal financial service. An individual with both a formal and an informal financial product would only appear under formal uptake.

The access strand applied to product markets

The access strand is also used to illustrate uptake across particular product markets (i.e. payments, savings, credit and insurance). The product market access strands also indicate those reached only by 'un-intermediated' financial services – financial services extended between family and friends, without being intermediated through a third-party institution or collective grouping. Thus, for example, saving at home, borrowing from friends and family, or sending a remittance with another person would be regarded as un-intermediated services.

The following particular financial products, services, mechanisms and activities have been included for each product market access strand:

Payments: transaction strand

Banked: Those who have a bank account in their own name.

Formal: Those who report having a mobile money account, but that do not have a bank account.

Payments: remittance strand

Banked: Those that use banks to send or receive remittance – some of these may also be engaged in formal non-bank remittance activities, informal remittance activities or friends and family remittance activities. Largest contributor: using bank accounts for remittance purposes.

Other formal: Those who have sent or received remittances in the previous 12 months via the post office, moneygram or other remit agent – some of these may also be sending or receiving money through informal channels or family and friends.

Informal: Those who have not sent or received formal remittance, but have sent or received remittance in the previous 12 months via a bus or *hundi* – some of these may also be sending or receiving money through family and friends or in person.

Family and friends or self-delivery only: Those who do not fit into either of the previous two categories, but have sent or received remittance in the previous 12 months directly via friends or family, or who delivered the funds themselves.

Savings strand

Banked: Those who save with or have a savings account with a bank.

Other formal: Those who save with or have a savings account with a SACCO, pension fund or post office – some of these may also be saving in an informal institution or at home.

Informal: Those who do not have a formal savings product (as defined above), but who save with a savings group – some of these may also be saving at home or by other un-intermediated means.

***Saving at home/with household members*:** Those who do not fall into either category above, but save in a secret place at home, in livestock, or in kind, within the household or family, or who ask another person in the community to keep money safe for them.

Credit access strand

Banked: Those who have a loan product or credit account with a bank – some of these may also be accessing credit from an alternative formal provider, accessing informal credit or borrowing from family and friends.

Other formal: Those who have a loan product or credit account with a credit institution, MFI or SACCO – some of these may also be accessing informal credit or borrowing from family and friends.

Informal: Those who do not have formal credit, but in the previous 12 months have borrowed money from an employer, savings group, or informal moneylender – some of these may also be borrowing from family or friends.

***Family or friends only*:** Those who do not have formal or informal credit as above, but in the previous 12 months have borrowed money from family or friends.

Insurance access strand

***Formal*:** Those with any formal insurance product (e.g. funeral insurance) with an insurance company – some of these may also belong to a burial society.

***Informal*:** Those who do not have formal insurance, but belong to an informal society such as Guthi (the social organisation aiming at integrated community development).

In brief

Geography

Landlocked, geographically diverse and prone to natural disasters.

Capital city: Kathmandu.

Shares borders with India and China, two of Asia's largest economies.

Geographically diverse terrain (lowest point 59 m; highest point 8,848 m).

Home to 8/10 of the world's highest mountains, including the highest point on earth: Mt Everest.

Southern Terai region is fertile and humid.

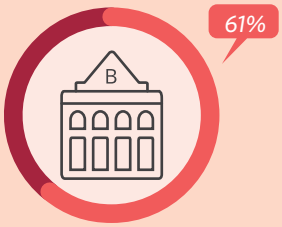
Five seasons: summer, monsoon (rainfall), autumn, winter and spring. Delayed monsoon can adversely affect crop growth cycles.

No direct ocean access. Nepal uses nearest port at Kolkata in India, under the Convention on Transit Trade of Land-locked States (UN 2015).

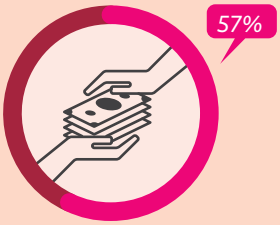
Located on edge of tectonic plate and highly vulnerable to earthquake risk: April 2015 quake had a devastating impact on infrastructure and overall economy – losses of NPR 200 billion (US$ 1.98 billion).

Natural disasters do not only affect economy but have lasting impact on livelihoods of the poor that are connected to industries vulnerable to these risks.

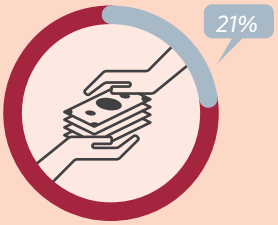
Financial access in Nepal



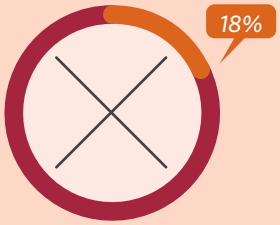
61% of the adult population report using at least one financial service from a formal financial service provider.



57% of adults make use of informal financial services.



21% of adults use *only* informal financial services.



18% of adults are completely financially excluded (from formal and informal services).

Breakdown of financial access in Nepal by product market

PAYMENTS

36% of transactions are made through digital channels.
33% of adults remit; **19%** of these do so through non-bank formal providers.

SAVINGS

40% of adults save with a formal financial service provider.
31% of adults save in informal savings groups.
16% of adults save at home in cash and assets.

CREDIT

29% of adults borrow from an informal institution.
18% of adults borrow from a formal institution.

INSURANCE

11% of adults have formal insurance.
41% of all those with insurance have life insurance.

Only 7% of the adult population use all four types of financial services.

Snapshot: The Nepali customer

Diverse set of economic activities necessary to sustain households. A large portion of the population take on additional economic activities to generate extra income, since the main source of income is often insufficient. FinScope (2014) illustrates:

- 48% of the adult population identify farming as an additional source of income.
- 19% of the adult population identify remittance as an additional source of income.

Even those who farm as their primary means of gaining income take on additional work; of the 32% of the adult population involved in farming, 57% have identified they are also involved in other work.

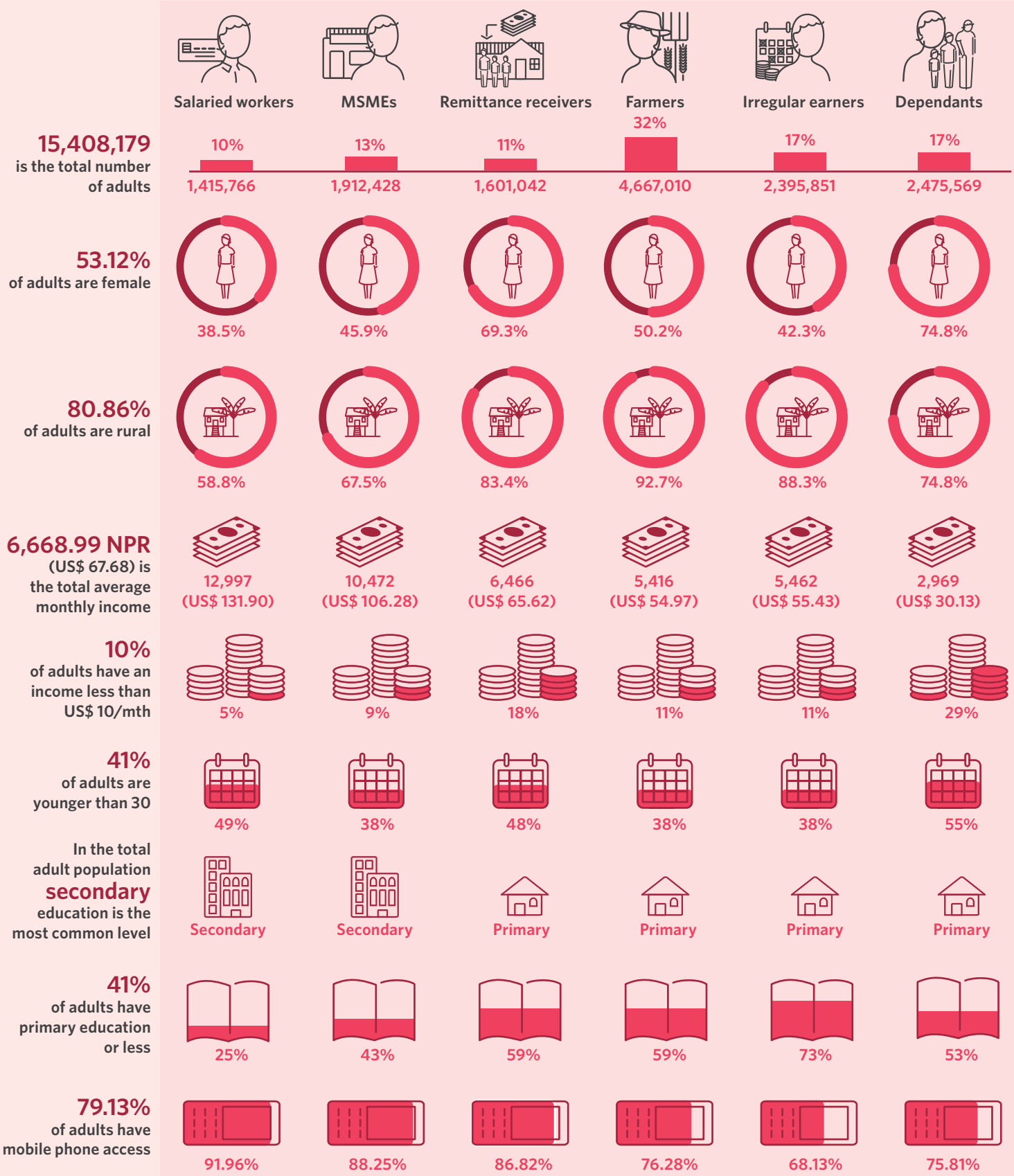


Figure 1: Basic target market indicators

Source: FinScope, 2014.

FARMERS

Lifestyle. 75% are subsistence farmers, 25% are trading farmers; seasonal income, very little risk protection.

Financial access. 65% use primarily informal financial services; 16% are financially excluded.

Depth of usage: 60% use two or more formal products; the most common combination is **savings and payments**, which constitute 14% of the total usage of financial services; 8% use all four formal financial services.

Product needs. Upfront capital and flexible repayment options; risk-protection mechanisms to mitigate agriculture risks and key-person risks; input financing services and storage-of-value accounts; consumption smoothing; productive credit for trading farmers.

*Current portfolio.**
Savings and credit: 27% have access to formal savings, 37% of farmers use informal savings channels.

Credit: 19% use formal credit; 36% (when overlaps are taken into account) use informal credit loans (from local merchants and local moneylenders), generally taken for consumption and social rather than productive purposes.

* Credit taken is sometimes linked to an informal contract farming arrangement: farmer takes loan/s from traders, merchants, wholesalers or retailers to whom farmer normally sells the produce, in return for a specified portion of the harvest at a pre-determined rate, irrespective of market prices at the time of harvest.

Payments: Half make use of payments products (driven by a third of farmers taking up remittance and transactions, respectively).

Insurance: Overall, insurance penetration relatively high: 13% use informal insurance only; 2% use both formal and informal insurance; only 8% use formal insurance.

Gender. Equal gender split (50%).

DEPENDANTS

Lifestyle. Average income less than half population average; income is irregular; little to no surplus income; main source of income is family/friends or government or welfare grant.

* An unusual dominance in hill areas (92% vs population average of 44%).

Financial access. 29% use formal financial services; 45% use informal financial services (highest levels of all the segments of access via informal channels); 33% are financially excluded.

Depth of usage: 44% use more than one financial product: the most used financial service is savings (12% of segment); the most common combination is **savings and payments**, with 11% using this combination.

Product needs. Consumption-smoothing financial products; affordable low-value savings; cheap, reliable payments products for income receipt; products to invest in human capital, such as improving skills and ability to generate an income.

*Current portfolio.**
Savings and credit: This is significant given low income levels, which leave very little surplus for saving or potentially covering credit payments.

Credit: Informal providers dominate credit provision, while both informal and formal play a key role in savings (e.g. about 26% of dependants are saving informally).

Payments: Payment products are accessed by a third of the group. When overlaps are taken into account, family and friends are the key provider for remittance (18% of dependants), while other formal (14%) and bank (6%) still play a significant role.

Gender. Female dominated (75%).

IRREGULAR EARNERS

Lifestyle. Second lowest income earners; income is lower than population average and almost equal to average income of farmers; income is irregular (piecework); are well placed to fill the workforce gap in rural areas that results from migration of others to urban areas/other countries.

* An unusual dominance in Terai region (62% vs population average of 50%)

Financial access. 33% primarily use informal financial services; 25% are financially excluded.

Depth of usage: 31% use only one financial service (17% of which use **credit** services); 44% use more than one financial product; 11% use a combination of **credit and savings**, while 10% use the combination of **credit, savings and payment**.

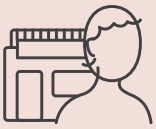
Product needs. Consumption-smoothing financial products; products to help mitigate risks; affordable and accessible savings, and credit, and potentially remittance; products to facilitate investment in productive potential and skills training.

*Current portfolio.**
Savings and credit: These are key products because they provide access to surplus funds (in both cases, use of informal providers dominates). When overlaps are taken into account, 36% and 27% of irregular earners access credit and savings this way, respectively. In combination, formal providers also provide 27% of irregular earners with savings products.

Not used much: Payments products, remittance and digital transactions, and insurance are notably low for this target market.

* Low and irregular incomes reduce the ability of the segment to commit to regular account payments or premiums. Given the cash-based economy, there is little incentive to take on additional cost of a transactional account.

Gender. Male dominated (58% male).



MSMEs

Lifestyle. Mostly family-run, with ownership and management controlled by family head; personal and family savings generally major source of capital; household and business needs conflated; significant contributors to economic development – the fairly large, mainly informal MSME economy is estimated to contribute 38% of GDP.

Financial access. 72% have access to formal financial services; 12% are financially excluded; also significant uptake of informal financial services (informal credit use tops formal, informal savings is on a par with formal providers).

Depth of usage: 67% use more than one financial product; 26% use a combination of two financial services; 31% use a combination of three financial services; the most common product combination is **credit, savings and payments** (16% of segment).

Product needs. Very big need for working capital; also need for investment capital to support business activities (e.g. credit and savings products); products to assist with mitigating risk attached to household and business – especially products that reduce key-person risk; cost-effective and easily accessible payment mechanism; committed savings products (for consumption smoothing).

*Current portfolio.**
Payments: Significantly 46% of MSMEs have access to formal payment services: these businesses can transact in both cash and through formal payment systems (mainly bank cheques).

Credit: More MSMEs have been able to access credit through informal providers; overall current access to credit (formal and informal) is at 50% of MSMEs; the majority of the capital financial requirement is met by ploughing back savings from the business – although there is usually still a credit gap.

Gender. High male dominance (61% male).

REMITTANCE RECEIVERS

Lifestyle. Currently depend on a third party for their income; the fact that remittance receivers receive a relatively higher income speaks to the earning potential of the migrants abroad; increasing trend of migration suggests the number of remittance receivers could continue to increase; remittance typically received quarterly or less frequently.

Financial access. 52% use formal financial services; remittance receivers have the highest access to financial services, driven by the fact that they need to access financial services to receive the income that is sent via remittance channels; only 4% are financially excluded.

Depth of usage: 68% use more than one financial product; 37% use a combination of two financial services; 23% use a combination of three financial services; the most common combination is **savings and payments**, with 19% using this combination.

Product needs. Cost-effective, reliable and accessible remittance channels; products to facilitate wealth building and asset accumulation (to invest surplus) e.g. home loans; products to protect against risk (financial safety net), especially due to high-income nature of target market; consumption-smoothing financial products.

*Current portfolio.**
Savings: Remittance is usually paid on a quarterly basis, so saving is necessary (both formal and informal providers): 28% save through informal providers.

Transactions: remittance receivers are also the second highest users of digital transactions.

Credit: 44% had accessed credit in the previous 12 months (mainly from informal providers, due to eligibility criteria).

Gender. Female dominated (69%).

SALARIED WORKERS

Lifestyle. Highest income earners (earn more than 1.24 times that of MSMEs); typically government and formal private sector employees; relatively high and regular income + documents for proof of income,

Financial access. 83% access formal channels (population average is 60%), and only 8% take up informal services; only 8% are financially excluded.

Depth of usage: 40% use only one or two financial services; 38% use a combination of three financial services; 15% use all four types; the most common combination is **savings, credit and payments**, with 19% using this combination.

Product needs. Insurance products: this is the main potential market for insurance; cost-effective transaction account for salary receipt, with functionality and affordable pricing that enable digital transactions; affordable, accessible and flexible credit and savings options appropriate for low-value amounts; products that support long-term wealth building (e.g. long-term savings and credit products); potential to use bundling of products to increase access further (cross-selling or bundling savings, credit, insurance and payment products).

*Current portfolio.**
Savings and transactional products: Saving products are key (78% of salaried workers save), followed by transactions (64% of segment); highest users of digital transactions.

Credit: dominant segment in terms of formal credit uptake

Insurance: highest access of all the segments to insurance (64% are excluded from access to insurance) – driven by high income levels and incentive push of tax rebate on purchase of life insurance products, plus mandated products by the government (e.g. vehicle insurance) or their employer (e.g. medical insurance).

Gender. High male dominance (61% male – likely a large proportion of breadwinners).

* The most used services are savings and transactions. Savings is the most popular product. The majority of the adult population uses financial services primarily for savings (59%), followed by payments (53%) and credit (46%). For credit, informal sources are still the most popular.

Table 1: Salient features of the six target market segments in Nepal

Context drivers of market development

Summary

- Nepal is a landlocked and geographically diverse country prone to natural disaster risks.
- The slow-growing economy is still reeling under the impact of the most recent (2015) devastating earthquake.
- Exogenous factors – such as delayed monsoon (which in turn means delayed rainfall), and migration of labour forces to neighbouring countries – greatly influence the economy.
- The country's per capita GDP is NPR 74,992 (US$ 762).
- Despite the fact that 25% of the adult population live below the international poverty line, income levels are relatively equitable.
- The population is young, minimally educated and rural, with a strong trend of young working men (and some women) migrating to neighbouring countries for work.
- Limited job opportunities mean that increased education levels are not translating into increased employment levels.
- This is a remittance-flush country; remittance contributes 28% to national GDP.
- Remittance inflows and aspirations of upward mobility on the part of the population mean that Nepal is becoming increasingly consumption oriented.
- Between 1991 and 2011, average life expectancy increased by 12 years, to 69 years.
- The society functions in a highly collectivist manner, with low official safety net coverage.
- Nepali society is highly patriarchal.
- Agriculture is the highest contributor to Nepal's GDP (approximately 32%) although this has been declining in recent years. Nevertheless, employment in the agriculture sector remains significant: an estimated 77% of the total adult population are either engaged in farming only or farming and other work.
- In 2014, the secondary sector contributed 15% of GDP, while the tertiary sector contributed 53%.
- The fairly large, mainly informal MSME economy is estimated to contribute 38% of GDP.
- The country has an extended history of high donor involvement in its development but efforts are not always aligned/well-coordinated.
- Low spending of allocated capital budgets hinders economic growth and development.
- Lack of good infrastructure is a major hindrance to economic growth and development.

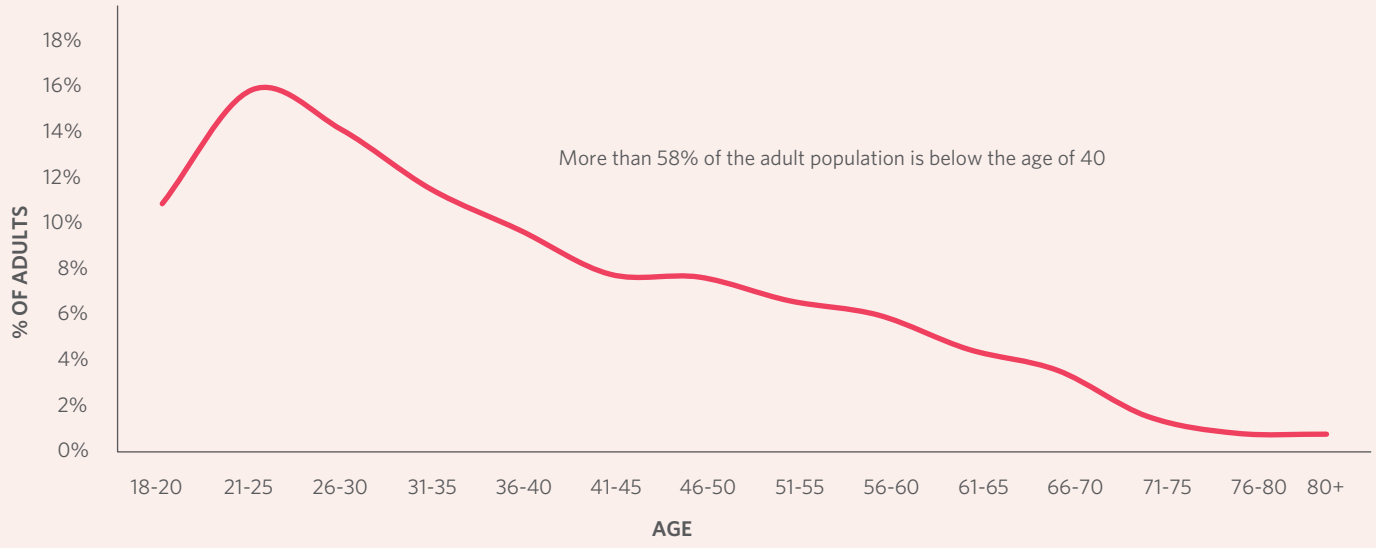


Figure 2: Adult population split across age (Nepal)

Source: FinScope, 2014.

Socioeconomic, demographic and cultural context

Predominately young and rural population with slight dominance of females. As at the latest census, the population of Nepal is 26.5 million people, with an annual growth rate of 1.35% (CBS, 2011). The age distribution is shown in Figure 2. The adult population of 18+ year individuals is estimated to be approximately 15 million, while 11 million people are under the age of 18. The adult population is split between 53% female and 47% male (see Figure 3). The majority of the adult population is located in rural areas (81%).

Poor, yet relatively equitable population income levels. The national poverty line was defined at NPR 7,696 (US$ 78) per capita income in 2004 and was later revised in 2011 to NPR 19,261 (US$ 195) per capita per year (Asian Development Bank, 2013). The national poverty indicator has been trending downwards, from 31% in 2004 to 25% in 2011, despite the increase to the threshold (Asian Development Bank, 2013).

Figure 4 depicts the income distribution of Nepal, showing that 75% of the adult population earn less than NPR 10,000 (US$ 101) per month, while the country's average monthly income is estimated to be NPR 6,669 (US$ 68).

The Gini index measures income distribution among individuals or households of a country, and the commonly used measure of inequality – the gap between rich and poor – is based on the cumulative percentages of total income received against the cumulative number of recipients, starting with the poorest individual and household. In 2013, Nepal's Gini index was 32.8, a score that indicates a relatively high level of income equality. This is a regionally competitive ranking compared to other South Asian countries such as India (33.9), Bhutan (38.1), Maldives (37.4) and Sri Lanka (36.4).

Income from informal sources is likely understated. It is important to note that the average income level figures are not entirely indicative of actual income, as they do not take into account understated secondary monetary income flows or income that is substituted by receiving benefits in-kind (e.g. payment in farming produce for services or rent). Given the high level of informality within Nepal's economy, it is very likely that income flows from informal sources are not accurately stated.

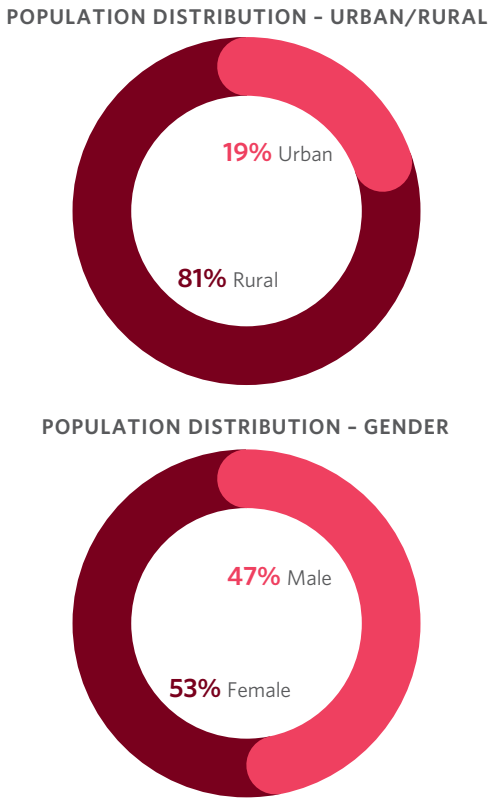


Figure 3: Adult population split, across gender and rural/urban, respectively
Source: FinScope, 2014.

Low human development index ranking. Despite the fact that poverty levels are dropping, Nepal is still an underdeveloped country. This is highlighted by the country's 2014 global human development index (HDI) ranking of 145 out of 188 countries. Although this is a one-step improvement from 2013's ranking of 146 (*The Himalayan Times*, 2015), it still reflects a low level of well-being and basic education attainment. The average years

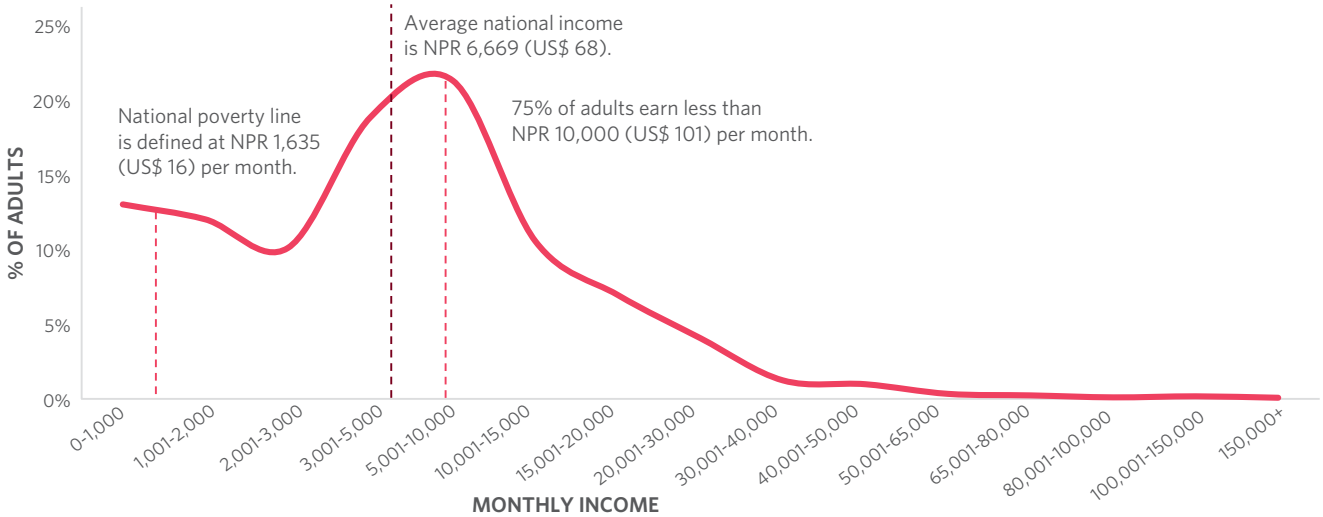


Figure 4: Monthly income distribution (Nepal)
Source: FinScope, 2014.

of education received by people aged 25 and older is only 3.3 years. Nepal's HDI score for women stood at 0.521 and that of men stood at 0.574 for men, categorising the country as having medium to low equality.

Low levels of official social protection. Even though poverty levels are reducing, the remaining vulnerable population lack official, reliable social protection safety nets.

The government's social assistance initiatives, including cash transfers and scholarships, lack focused targeting and significant benefits, resulting in a very limited impact on poverty (The World Bank, 2015; Ministry of Finance, 2015/16).

Examples of government schemes are: free public education; non-contributory targeted social protection programmes for specified groups; and subsidies and grants for farmers, industry and traders. With regard to the formal sector of the economy, the government has introduced contributory social protection, where benefits are channelled through public and private companies. However, these schemes have often not achieved full implementation in practice (UNDP, 2014). Provisions have also been made for disaster relief social protection schemes – such as national disaster emergency relief, which sees to the needs of flood and landslide victims. Disaster victims also get tax exemption and debt relief (UNDP, 2014). Sectoral relief schemes – e.g. agricultural disaster relief programmes – are also available in terms of which crop and/or livestock losses get compensated, usually in the form of free seeds and inputs, and vaccines/medications or occasionally replacement of stock (Khanal, 2012).

The official number of allowance beneficiaries in FY 2014/15 was a sizeable figure: slightly exceeding two million, which equates to roughly 7% of the total population (Ministry of Finance, 2014/15) (see Table 2). Many development partners have pitched in to extend the level and coverage of social protection benefits, but these schemes remain fragmented and as a result have limited effectiveness (Ministry of Finance, 2012).

Beneficiary	No. of beneficiaries	Schemes
Senior citizens	951,419	• Monthly allowance of NPR 1,000 (US$ 10.15) for citizens above 70 years of age. • Cash support to senior citizens older than 65 for health treatment. • Free treatment of certain illnesses for citizens over 75 years old.
Single women	648,553	• NPR 500 (US$ 5.07) per month for widows, dalits, and residents aged 60+ in the poor, remote region of Karnali.
Disabled people	33,578	• Monthly allowance of NPR 1,000 (US$ 10.15) per month for fully disabled, 16+ aged citizens and NPR 300 (US$ 3.04) per month for partially disabled people. • Special provisions available such as discounts and tax exemptions on certain services.
Endangered communities and marginalised castes	20,308	• NPR 500 (US$ 5.07) per month for all household members.
Child	506,718	• NPR 200 (US$ 2.03) per month per child under the age of 5 for up to two children for all Dalit families and all families in Karnali as Child Protection Grant.
Conflict victims	number unknown	• Monthly allowance of NPR 1,000 (US$ 10.15) for 12 months for 4,000 households in 5 districts. • NPR 60,000 (US$ 608.95) per year as livelihood support, along with educational allowance, for families of martyrs. • For the injured, compensation ranges from NPR 80,000 (US$ 811.94) to NPR 200,000 (US$ 2,029.84) depending on the degree of injury.

Table 2: Cash transfer social security schemes

Source: UNDP 2014; Ministry of Finance, 2015.

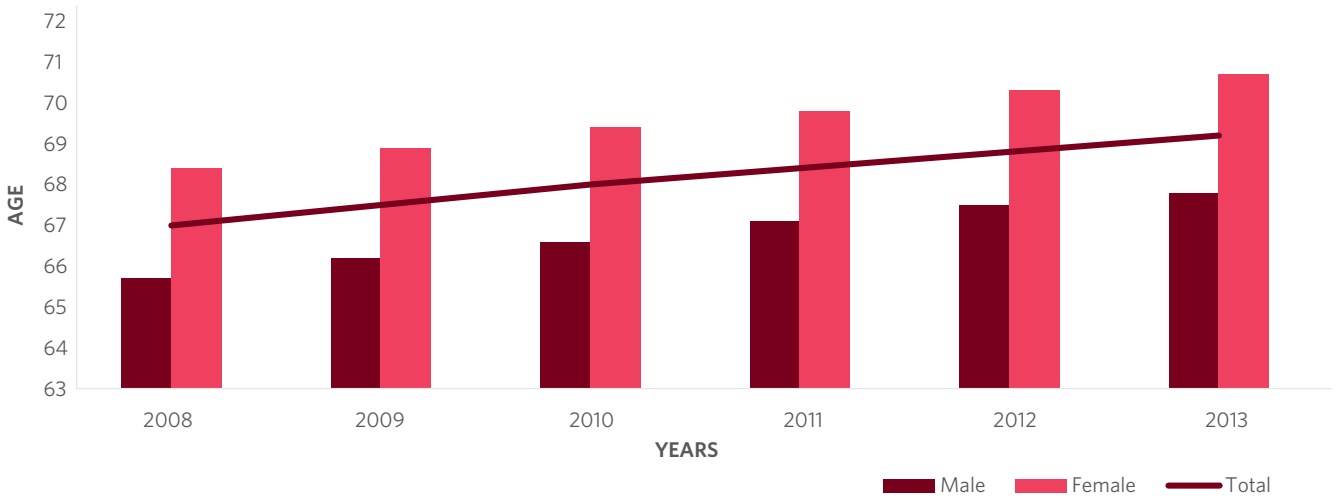


Figure 5: Average life expectancy in Nepal
Source: The World Bank, 2015.

Nepali people are living longer. The average life expectancy in Nepal has increased in the past decade (see Figure 5), to an average of 69 years – marginally above the regional average for South Asia (68 years) (The World Bank, 2015). The life expectancy trend reflects growth of 12 years between 1991 and 2011 (Central Bureau of Statistics, 2014) – the result of better access to health care, education, nutrition and immunisation, which also contributed to decreasing child and maternal mortality rates (Central Bureau of Statistics, 2014). Another factor that has contributed to increased life expectancy is the increase in per capita income. The general public are now able to afford better medical care and nutritious food.

Poor health care infrastructure. Both public and private institutions provide health care in Nepal. These facilities, along with sanitation and nutrition levels, are generally of poor quality, especially in rural areas (Ailuogwemhe, et al., 2005). Public and privately run hospitals are found in urban areas, while rural areas mostly have health care centres. While the majority of the population live in rural areas, most of Nepal's health care infrastructure is concentrated in urban areas. The result is that individuals' health treatment is delayed and accessing health care costs more (Bhatta, et al., 2015).

The demand for health care services is further decreased by the lack of health education in the country. Women are disadvantaged by general lack of emphasis on reproductive health care (Haviland, 2014). Individuals without a citizenship document are marginalised and denied access to government welfare benefits (UNDP, 2009).

Primary health care free – but low uptake. Although the government has initiated free primary health care, the issues of lack of proximity and non-availability of drugs and services have resulted in low uptake. The government has made provision for free in-patient and emergency health care services for the poor, destitute, disabled, senior citizens and female community health volunteers. In 2014, a total of 16,532,035 individuals benefited from this service (MoHP, 2014).

Inadequate funding for health care. One of the key causes of poor health care has been noted to be inadequate funding (Dhakal, et al., 2009). Donors have partnered with government to assist with improving the quality of health care. The NGO and INGO players are mostly prevalent in secondary and tertiary care, while government efforts are concentrated on public health and essential health care services, along with some secondary and tertiary care (AIN, 2014). Furthermore, there are private sector players that focus on drug production, human resource production and health facility management (Ministry of Health and Population, 2010).

Highly collectivist society. Nepali society is characterised by strong social connections. This collectivist emphasis is seen not only at the family level but also within the community as a whole. The close-knit structure of Nepali society means that family and friends are often the first points of contact when the need for finance arises, and collective functioning therefore has implications for financial services such as risk protection, among others. For example, both the MAP qualitative research and FinScope (2014) suggest that Nepali people either take on additional credit or depend on family members or community support to offset risk experiences. This is one of the primary reasons that informal channels are still prevalent across all adults despite their involvement in the formal market.

Growing trend of migration of working-age men. The country's persistent political instability and lack of widespread job opportunities in the country have made foreign employment the best alternative for Nepalis:

- In FY 2014/15, more than 500,000 Nepalis opted to work abroad (Department of Foreign Employment, 2014).
- In the past five years, 2.2 million Nepalis were working abroad, with the number growing by 12% per year (Department of Foreign Employment, 2014).

The escalation of the Maoist insurgency in the 1990s, accompanied by slow growth of the domestic economy, initially triggered this significant labour migration. In particular, the lack

of adequate employment opportunities outside the agriculture sectors compelled the expanding labour force to look for jobs outside the country (FAO, n.d). Moreover, the low salary structure in the economy, economic and other insecurity in the rural areas, and higher demand for labour in industrialised and Middle East countries are contributing factors to increasing migration (Shrestha, n.d.).

In terms of the age of migrants, about 37% of the 15–29 year age group and 28% of the 30–44 year age group are estimated to be working abroad, which includes informal channels for working abroad (CBS, 2011).

Official figures put female migrant workers at 5% – though the real figures could be higher. In terms of gender composition of migrants, around 95% are male and the rest female (Department of Foreign Employment, 2014). Actual numbers, however, are thought to be higher, given that migrants are known to use informal channels for working abroad – especially in India, where work permits are not required – and thus often go undocumented in the official figures. An ILO study estimates female migration to be as high as 12% of migrants when informal channels are taken into account (ILO, 2014).

Nepali society is highly patriarchal. This emerges from the dominant religion in Nepal – Hinduism –which posits the male as the head of the family. With approximately 81% of the population (CBS, 2011) subscribing to this belief, the patriarchal structure is deeply engrained in Nepali society. One example of how this plays out in society is in terms of control over income; the MAP qualitative and quantitative studies alike show that males are more likely than females to have more direct control over their income generation.

Shifting population dynamics from migration. With a high incidence of males migrating abroad for work, increasingly the adult population is skewed towards females. This has resulted in a change in the composition of households, with an increasing trend towards female-headed households. However, while women have in many instances taken on the role of heading the household in day-to-day matters, key decision-making with regard to financial services is still undertaken jointly or under direction from male spouses.

Migration of males impacts on the labour supply. Given that a high percentage of the population is rural and linked to farming, the (mostly) male migration to other countries for work is likely to have an impact on the agriculture sector. Additionally, farming in Nepal is highly labour-intensive, with commercial farming constituting less than 1% of the country's farming activity. This, together with the dearth of men, coupled with the fact of women juggling housework and fieldwork, has already started impacting upon agricultural output. By the same token, other jobs requiring intensive physical labour – e.g. construction – are likely to face reduced supply of male workers.

BOX 1. GROWING INTERNATIONAL TARGET MARKET

Nepali diaspora population growing larger annually.

Government data indicates that in the past six years, 2.2 million Nepali adults, i.e. 8% of Nepal's total population (Ministry of Labour and Employment, Department of Foreign Employment, 2013/2014), have been issued with labour permits to work abroad by the Department of Foreign Employment, with this number growing on average by 19% annually (Department of Foreign Employment, 2013/2014), and with a staggeringly high 137% increase between 2008/09 and 2013/14. Actual numbers could be significantly higher than reported because many people travel through the relatively 'porous' border with India without officially registering. Although Nepalis working abroad are not a direct target market for financial inclusion in Nepal, they should be considered as being among the key drivers, in that they enable the other target markets through remittances. For this reason, financial inclusion strategies should consider leveraging this sector to the extent that they play this enabling role.

Low educational attainment. As mentioned, the mean years of schooling figure in Nepal is low. While there has been an increase in the number of children enrolled in schooling, levels of enrolment past primary education remain low. Over the past five years, on average 69% of individuals who were enrolled in primary school continued to lower secondary level, while only 52% of individuals who were enrolled in lower secondary continued to upper secondary.

Increase in literacy rates. Despite this trend, there is evidence of an increase in literacy rates over the past decade (The World Bank, 2015) – for the adult population aged 15+:

- The average literacy rate in 2001 was 48.61%.
- The average literacy rate in 2011 was 59.60%.

Basic public schooling free but of low quality. Both public and private schooling options exist in Nepal. Privately owned schools are concentrated in the urban areas, while community schools running on government grants are spread across urban and rural areas.

The government has made basic education from grades 1–5 free and compulsory, while education from grades 6–12 is free at government schools (*Himalayan Times*, 2015). The cost of textbooks, stationery and school uniforms must still be covered by parents.

The quality of government schooling is low, and it is widely agreed that the schooling system in Nepal needs to be reformed (Anon., n.d.).

The school-leaving certificate examination, taken at the end of grade 10, is looked upon as the benchmark for the literacy level in the country. However, in 2015, only 47.43% students passed the examination, and this was considered to be the highest pass percentage in the four-year period to 2015 (Ghimire, 2015). Furthermore, around 80% of students appearing for the exam from government schools failed to pass the exam. This has further lessened the credibility of government schools and has raised questions about their effectiveness.

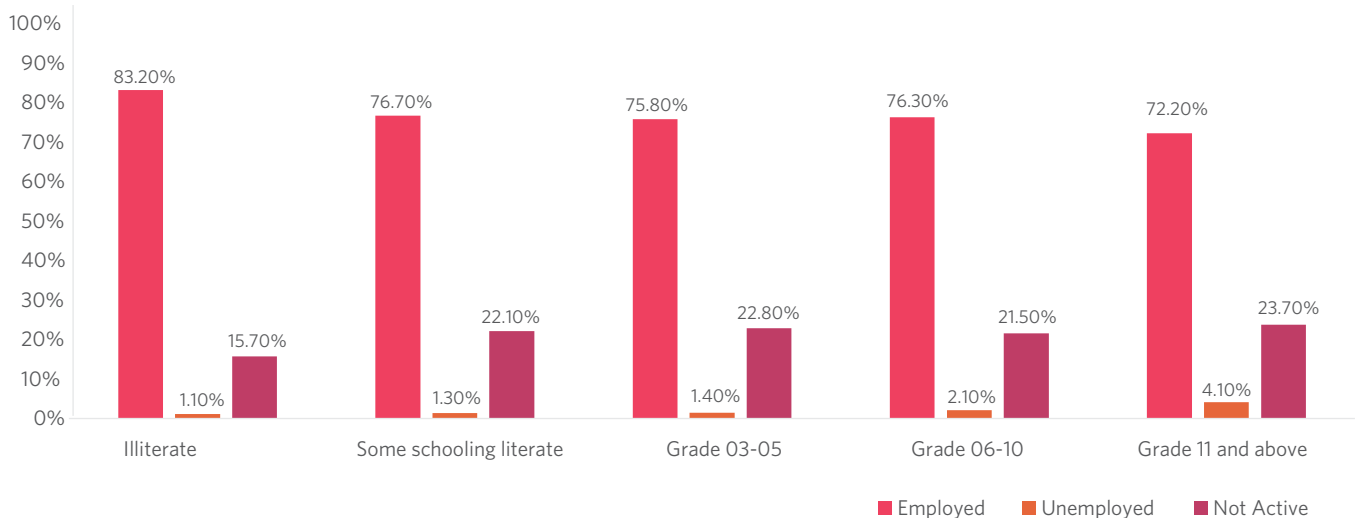


Figure 6: Educational attainment and employment trend (2011)
Source: CBS, 2011 (Nepal Living Standard Survey).

Public schooling improvements under way. The government is currently implementing the School Sector Reform Plan (2009–2015) to increase access to and improve the quality of school education for children from marginalised groups (Bank, 2015). The plan includes improvements to infrastructure and provision of training to teachers to improve their capacity.

Private schools preferred for their better quality, despite the expense. Parents prefer where possible to pay to send their children to private schools in the urban areas, which means an additional financial burden for boarding expenses.

High levels of school dropout. There are two main reasons for the high levels of school dropout: a lack of financial resources to pay for education, and the high opportunity cost that attaches to keeping children from engaging in income-generating activities at an early age. Schoolchildren often drop out in order to work to support their families; the 2011 Nepal Living Standard Survey showed that 22% of total enrolled students dropped out of school as they had to help at home (CBS, 2011).

A limited number of tertiary scholarships – and still expensive. The government covers tertiary tuition costs of a pre-determined number of students through scholarships; not all students receive these scholarships and even those who do still have additional expenses (textbooks, living expenses).

Educational attainment not translating into employment. As shown in Figure 6, the level of employed individuals appears to be falling with increased levels of education: Nepal's unemployment rate in 2014 was 2.7% (The World Bank, 2015). Rather than increasing employment levels, the added year of schooling is resulting in increased *unemployment* and inactivity.

Limited employment opportunities contributing to migration. This speaks both to the lack of employment opportunities in the country and to the type of employment opportunities, and both are also drivers behind the ongoing migration of labour at all skill levels. With an increased literacy rate has come increased aspiration for education, but the lack of white-collar jobs to sustain the educated workforce means that increased education levels do not translate into increased employment levels.

Highly consumption-based economy. Furthermore, Nepal is a highly consumption-based economy, with the contribution of the manufacturing sector showing an average growth rate of only 2.6% in the past 10 years (Ministry of Finance, 2014/15); and this lack of white-collar jobs can lead to further migration of semi-skilled and skilled workers.

Value-based society creating consumption obligations. Nepal has a highly value-based society, where cultural and social practices have been handed down from generation to generation over centuries. Such practices entail social obligations, and failure to meet such obligations carries negative social connotations. The vicious circle of indebtedness that is evident among Nepal's poor arises partly from the constant financial pressure to meet obligations, which prompts people to seek credit for unproductive activities (29% of the adult population borrow from informal providers, and 18% from formal). Cultural obligations stem primarily from religious practices as well as societal pressure on major life events such as such as death, birth rituals or weddings.

"I own this plot of land but I put it up as a collateral with the village moneylender as I needed funds for my daughter's wedding. We had a grand party; almost the entire village was invited." (Farmer, male, aged 40)

Cultural practice of investing in assets. The practice of buying and giving gold/silverware and ornaments as gifts is deeply ingrained in Nepali society, where buying jewellery at times can be seen as a forced saving arising out of social obligations. Although FinScope (2014) data shows that 7% of the adult

population save in gold/jewellery, according to qualitative and desktop research this figure is likely to be understated. Similarly, investment in fixed assets is a common occurrence among adults. The qualitative research shows that individuals are purchasing gold or investing in land; however, they do not necessary term these purchases 'savings' but rather a tool for mitigating risks or ensuring fulfilment of social obligations (e.g. making gifts of gold jewellery to daughters who are getting married). Furthermore, since the real estate and gold markets are considerably liquid, such assets can be converted into cash fairly easily in times of need.

BOX 2. CASTE SYSTEM AND ACCESS TO FINANCIAL SERVICES

The nature and format of financial services can be impacted on by social strata. *The impact of social strata on financial services usage can be seen in a number of areas. For example:*

- *The village moneylenders are generally people belonging to higher castes as an outcome of their higher financial endowments. Lower-caste members are often forced to rely on these providers due to a lack of sufficient financial resources or collateral to qualify for formal financial services. Interest rates on credit obtained from moneylenders are very high.*
- *The MAP qualitative survey (2015) showed that there is a social stigma and fear among the lower-caste people that moneylenders will cease giving credit if borrowers are found to be accessing formal financial channels.*
- *Where group mechanisms are used for financial services provision, adoption of this mechanism can be influenced by social stratification, in that prospective members are likely to join and stay in the group if other members are from the same social strata (MAP supply-side survey 2015).*

Relatively peaceful society. Nepali society has relatively low levels of crime and is a society that is generally at peace. Instability stems primarily from the political situation within the country and ensuing protests. While there are cases of violence stemming from these protests, for the most part society reacts peacefully, maintaining order even during periods of upheaval, as shown by the reaction of the populace to recent insurgency, earthquake and economic blockade.

The socioeconomic, demographic and cultural context are significant drivers of consumer behaviour, while also setting the market context. For example, while it is not necessarily explicit in the data, the national education context has implications for households, particularly poor ones, in terms of the extent to which consumers have to subsidise their children's education; consumers' valuing of a good education combined with poor national delivery means that households take on an additional financial burden with regard to education provision. Similarly, an inadequate health care system means an additional household risk burden, often combined with the added burden of families needing to provide financial support for older relatives who have retired but lack retirement funding.

Macroeconomic context

Slow-growing economy. Nepal has a GDP of NPR 2,124 billion (US$ 21.3 billion), with per capita GDP amounting to NPR 74,992 (US$ 762) (Ministry of Finance, 2014/15). Nepal's economic growth over the past decade has averaged 4.1%, with the growth rate exceeding 5% only in 2007/08 and 2013/14.

Compared to the developing economies of South Asia, Nepal's GDP growth has historically lagged behind. This trend looks set to continue in the near future; World Bank data estimated Nepal's GDP growth to further decline in 2016, to hit a low of 1.7%, while the growth of South Asia's developing countries was estimated at 7.3% (The World Bank, 2015).

Agriculture sector growth declining. The agriculture sector is the highest contributor to Nepal's GDP (around 32%, as shown in Figure 20), but this contribution has been in gradual decline in recent years. Productivity has not increased. This can be explained by inadequate capacity expansion in agriculture research and innovation, despite government targets to revive the sector and make the country self-reliant in grains (Ministry of Finance, 2014/15). High input costs and underdeveloped infrastructure are further key constraints. Although the government is importing improved seeds and chemical fertilisers, their availability remains uncertain and costly to farmers. In terms of the market for produce, lack of reliable and good road connectivity constrains large-volume production, especially in the hilly areas where the temperate climate is suitable for high-value agriculture. These key constraints have contributed to the shrinkage of the agriculture sector.

Nevertheless, agriculture is still significant. Nepal still has high labour utilisation in agriculture, with an estimated 77% of the population engaged either in agriculture alone or farming and other activities (FinScope, 2014).

Other contributors to GDP. In terms of contribution to GDP, agriculture is followed by wholesale and retail trade (contributing 15%) and then by financial and real estate services (contributing 13%) to the economy (see Figure 7). As the secondary sector (comprising manufacturing, electricity, gas and water, and construction sub-sectors) and the tertiary sector (comprising the service sector) experience growth, the country's economy is slowly moving away from agriculture; in 2014, the secondary sector contributed 15% of GDP, while the tertiary sector contributed 53%.

Remittance-dependent country. Remittances play a significant role in the economic development of Nepal. In 2014/15 the value of remittance inflows was estimated at almost 28% of national GDP (Ministry of Finance, 2014/15). According to the World Bank, Nepal stands third among countries in terms of the proportion of remittances to GDP.

Nepal received remittance amounting to NPR 589.5 billion (US$ 6.19 billion) in 2014/15 – growth of 11.9% from the previous fiscal year, and an average year-on-year growth of 22% over the five-year period up to 2014/15 (Nepal Rastra Bank, 2015) (see Box 4).

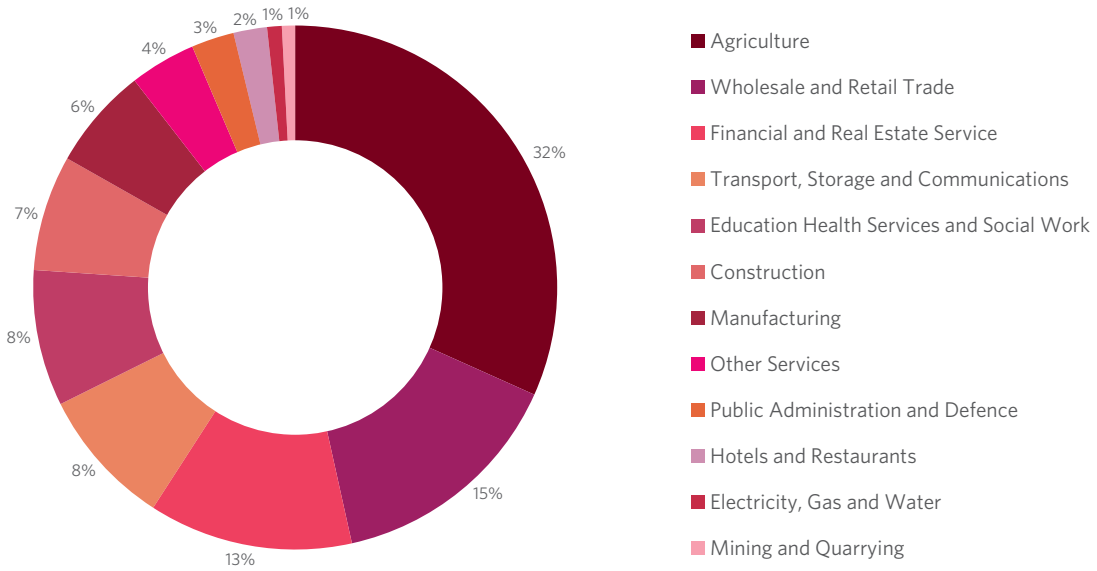


Figure 7: GDP breakdown per sector (2014)
Source: Central Bureau of Statistics, 2015.

BOX 3. AGRICULTURE IN NEPAL

Agriculture-based economy with mainly rain-fed production. *In Nepal's predominantly agriculture-based economy, the Terai region (also known as 'the plains') is considered the most fertile and cultivable land, with easy irrigation systems, good climate and good infrastructure. This belt is the storehouse of food and grains for the country. The two other regions – hills and mountain – have fragmented plots of land and are difficult to cultivate.*

Irrigation is heavily dependent on the monsoon, with the country witnessing several irregular rainfall patterns. Most farmers in Nepal depend on rainfall for irrigation activities, given that only 67% of the total arable land is irrigable; and of that irrigable land, year-round irrigation is only available to 40% (Ministry of Finance, 2014/15).

Rice is a key food crop. *Most of the cultivated land in Nepal (80% of the total) is used to grow cereal crops. The country's primary food crop is rice, with millet, wheat, barley and buckwheat constituting the other major food crops. The country's major cash crops are oil seeds, tobacco, jute, sugar cane and potatoes. Tobacco, oil seeds, sugar cane, jute, tea, coffee, cotton, honey and mushroom are considered industrial crops (i.e. grown to produce goods for manufacturing). Nepal also exports lentils, cardamom, tea, coffee, ginger, garlic, spices and flowers.*

Table 3 shows land area and production figures for cultivation of the country's main crops (2014/15).

Livestock and poultry farming and fisheries also play a significant role in meeting the livelihood needs of the population. Livestock farming is yet to be scaled into high commercial value but poultry farming and fisheries have become relatively lucrative businesses (FAO, 2014).

Crop	Area (hectares)	Production (MT)
Rice	1,425,346	4,788,612
Vegetables	245,368	3,629,000
Sugar cane	66,600	3,063,000
Potatoes	190,228	2,842,000
Maize	882,395	2,245,291
Wheat	762,373	1,975,625
Fruits	111,686	1,186,369
Pulse	326,400	353,500
Millet	268,050	308,488
Oil seeds	217,225	194,536
Barley	28,053	37,354
Tea	19,350	22,500
Jute	11,400	16,530
Buckwheat	10,819	10,870
Tobacco	1,724	2,227
Coffee	1,925	450
Cotton	225	202

Table 3: Main crops in Nepal – land area and production (2014/15)
Source: Ministry of Agriculture, 2015.

Majority of farming is for subsistence purposes. *Although 77% (11.5 million adults) of the adult population are engaged in some capacity in farming activities, only 0.3% (44,000 adults) of them are currently farming for the sole purpose of selling; 75% of those who are farming are subsistence farmers. This means that, of the total adult population, 44% (6.8 million) are farming for consumption only (FinScope, 2014). The high level of subsistence farming likely accounts for the agriculture sector's declining contribution to GDP.*

BOX 4. REMITTANCE IN NEPAL

Increasing remittance flows. *The flow of remittance into Nepal has been on the increase in the five-year period 2010/11–2014/15:*

- *In nominal terms, the remittance amount increased from NPR 253.5 billion (US$ 2.4 billion) in FY 2010/11 to NPR 617.3 billion (US$ 5.8 billion) in FY 2014/15.*
- *On average, remittance inflows grew by 21% on a year-on-year basis for the five-year period.*

The share of remittance contribution to GDP has also been increasing (see Figure 8):

- *In 2014/15, Nepal received remittances exceeding NPR 1.5 billion (US$ 14.2 million) daily (Ministry of Finance, 2014/15).*
- *85% of the remittances were received by rural households (Ministry of Finance, 2014/15).*
- *In terms of their profile, the migrant workers sending these funds were reported to be mainly blue-collar workers (Dhungana, 2012).*

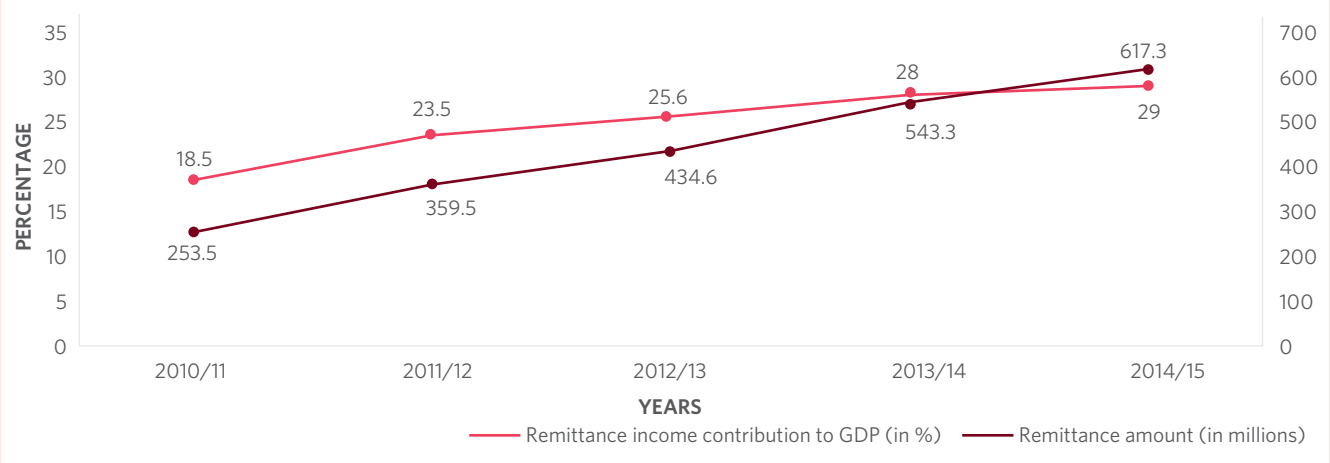


***Figure 8**: Trend of remittance growth, and contribution of remittance income to GDP*

Source: Ministry of Finance, 2015.

Exposure to shocks. This large and growing contribution opens Nepal to exposure to external shocks linked to remittance-sending countries. Furthermore, while the huge inflow of remittance money has contributed in uplifting the living standard of millions of Nepali people, these inflows have had the knock-on effect of increasing imports; given the stagnation of local industries and lack of investment opportunities within the country, the high import levels have mainly been sustained by remittance. The economic survey shows that the greater portion of remittance is being spent on consumption, and this consumption demand is being met by imported items (Ministry of Finance, 2014/15).

Remittance income for the most part spent on food. Despite the encouraging figures in remittance incomes – which have aided the nation in increasing the volume of foreign reserves, maintaining a balance-of-payments surplus and bolstering incomes – investments of the received remittances in productive sectors have remained woefully low (Ministry of Finance, 2014/15). As flagged in the section of this report on the market for payments, 57% of Nepali adult who receive remittances spend the money on buying food: only 14% save the remittance money, while only 7% use it to buy land or a house and only 7% use it to invest in business.

Widening trade deficit. Figure 9 shows the trade composition of Nepal for 2014/15. There is a widening trade deficit, and the export–import ratio has decreased to 11% from the previous year's 13%. The gap between production and consumption has resulted in a trade imbalance, which continues to rise every year, with the result that import volumes are as much as eight times higher than export volumes.

Nepal increasingly importing agricultural products. Nepal had traditionally been dependent on the import of manufactured goods such as machinery and electronics. Now, however, the country is increasingly importing agricultural products as well (see Figure 9).

A record high balance of payments. Despite the trade deficit, Nepal has continually registered a surplus balance of payments. The recent surplus registered a record high of US$ 1.43 billion, which is equivalent to 6.8% of the country's GDP (Ministry of Finance, 2014/15).

The surplus is attributed to low growth of exports, increase in remittance inflow, and grants (Ministry of Finance, 2014/15). While there is a growing merchandise trade industry, this is offset by the much larger inflow of goods and capital.

Signatory to several trade agreements. Nepal is a signatory to a number of bilateral, multilateral and regional trade agreements: the country is a member of the World Trade Organization (WTO), South Asian Free Trade Area (SAFTA) and Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC). In addition to regional and international trade agreements, Nepal has entered into bilateral investment treaties with India, France, Germany, Mauritius and the United Kingdom, among others.

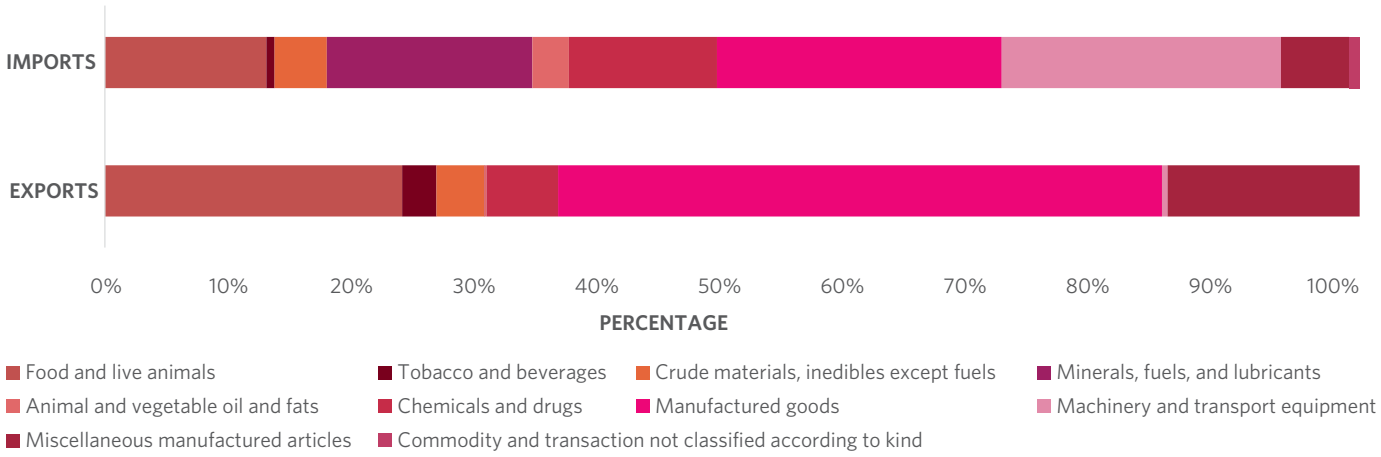


Figure 9: Import–export composition of Nepal (2014/15)
Source: Ministry of Finance, 2015.

BOX 5. MSME LANDSCAPE

Micro, small and medium enterprises fall under the purview of the Ministry of Industry – Department of Cottage and Small Industries. The official distinctions between the MSMEs, as per the Industrial Policy (2010), are as follows:

Type of industries	Fixed assets	Turnover	No. of employees
Micro enterprises	Up to NPR 200,000, excluding land and building.	NPR 2 million	Fewer than 10, self-employed and self-managed.
Small enterprises	Less than NPR 50 million, including land and building.	N/A	Fewer than 20 people.
Medium enterprises	More than NPR 50 million but less than NPR 150 million, including land and building.	N/A	N/A

Source: Ghimire, 2011.

Nepal MSME profile	
Total no. of enterprises	385,377
Size distribution	98.6% micro enterprises; 1% small enterprises; 0.4% medium enterprises
Employment	More than 2.5 million

Source: Ministry of Finance, 2015.

MSMEs have ambiguous sectoral composition. *Given that agriculture is the mainstay of the Nepalese economy, the majority of MSMEs, which often go unnoticed in the official numbers, are agro-based, forest-based, or livestock-based (Ghimire, n.d). However, the figures (according to the Department of Cottage and Small Industries) point to a high prevalence of services and manufacturing-oriented MSMEs. Agriculture-oriented MSMEs provide seasonal output, and activities that feed into this base – e.g. weaving, knitting, basketry, teashops and roadside shops – are known to substitute during the off seasons (European Economic Chamber Nepal, n.d.).*

Poor management practice, lack of information and low capital base identified as MSME challenges. *The prev alence of traditional management practices (which often result in less efficient production processes), a lack of technical knowledge coupled with inaccessible information about business opportunities and marketing, and a lack of financing have been identified as barriers to growth for MSMEs (Ghimire, n.d.).*

Acknowledging the potential benefit of MSMEs to the economy, the government and various multilateral organisations and NGOs have made provision for a range of skills development and training programmes throughout the country (Ghimire 2011). Once training is completed, the department also provides access to financial support for the entrepreneurs and enterprises (the financial support provided generally covers subsidised credit facilities). In addition, various organisations such as the Micro Enterprise Development Program (MEDEP), Grameen Bikas Bank, and other private sector microfinance banks, FINGOs and cooperatives have been providing support programmes across Nepal for awareness, skills development and financial access related to MSMEs.

Informal MSMEs are a major constituent of the economy. Accounting for 70%–80% of the total value of Nepal's industrial production, about 80% of employment, and 70% of the total value of all exports, MSMEs are major contributors to the economy (FAO, 2009).

Nepal's informal economy contributes approximately 38% to GDP. The country ranks 76th out of 120 countries in this regard, with Nepal being labelled the country with the largest 'shadow economy' (Scheider, et al., 2010).

Micro-enterprises accounts for more than 98% of the MSMEs (see Box 5). The reports from the Department of Cottage and Small industries have shown significantly higher number of males taking an entrepreneurial role (Department of Cottage and Small Industries, 2013):

- Most of the *formal* enterprises are initiated by NGOs or government agencies with the intention of creating a source of income for poor and underprivileged families.
- The *informal* enterprises are generally initiated by individual families to make a living using their traditional craft skills.

Low capital spending, decreasing budget deficit. The government issued a budget of US$ 8.2 billion for FY 2015/16. Of the total budget:

- Approximately 60% is allocated to recurrent expenditures.
- 25% is allocated to capital expenditure.
- The remaining 15% is allocated to financing expenses.

Despite budget allocation, capital spending has remained extremely low, with less than 75% of the total budget allocation spent in 2014/15. Such under-spending has been a consistent trend in recent years and has had the effect of greatly suppressing economic growth.

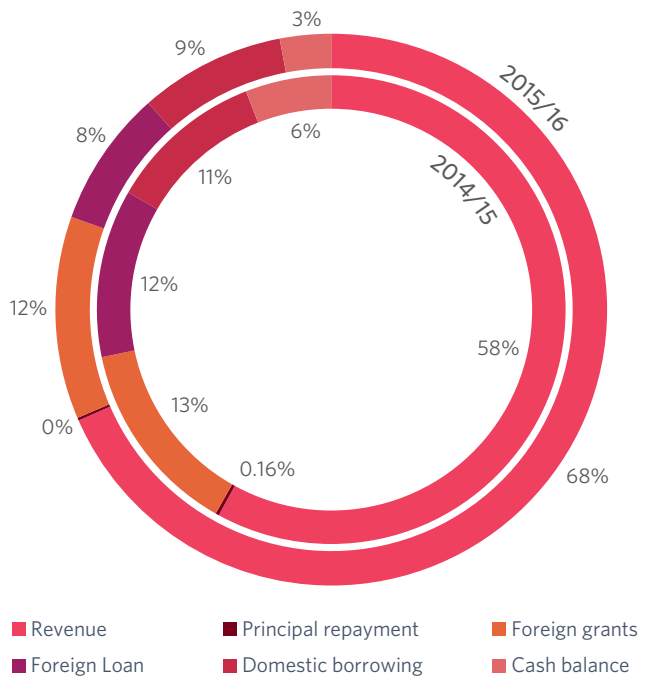


Figure 10: Composition of budget financing (2014/15 and 2015/16)
Source: Ministry of Finance, 2015/16.

As a result of the 2015 earthquake and the increased requirement for reconstruction spending, the budget for FY 2015/16 was a 57% increment on the expenditure of 2014/15. In terms of source of funds, 80% was anticipated to be financed through revenue mobilisation, while only 19% was to be financed through foreign grants (Ministry of Finance, 2014/15).

The budget deficit sits at 5% of GDP, which is an increase of 2% on 2013/14 (Ministry of Finance, 2014/15). As shown in Figure 10, 12%–13% of the government budget is covered through foreign grants, while the major portion is covered through the mobilisation of government revenue.

BOX 6. ROLE OF DEVELOPMENT PARTNERS AND FOREIGN AID IN THE ECONOMY

Extended history of high donor involvement. *A large number of donors have joined efforts in assisting Nepal in various developmental activities. The total volume of aid disbursed in FY 2013/14 was US$ 1.11 billion.*

In the same year, of the total Official Development Assistance disbursement:

- *Around 52% came from multilateral donors.*
- *40% came from the Organisation for Economic Cooperation and Development's Development Assistance Committee (OECD-DAC) bilateral donors.*
- *The remaining amount came from India and China, Nepal's two major bilateral south–south cooperation partners.*

The top five largest aid-receiving sectors during the period – receiving around 56% of the total disbursement – were education, local development, health, energy, and road transportation.

The alignment of aid resources in the government's Three Year Plan (2013/14–2015/16) reveals that, of the total disbursements (IECCD, 2015):

- *The Social Development Policy area receives around 39%*
- *The Infrastructure Development Policy area receives around 26%.*
- *The Macro-economic Policy and Economic Development Policy area receives around 25%.*
- *The remaining 10% goes to good governance, human rights, peace, rehabilitation, inclusive democracy and other cross-cutting sectors.*

Recent natural disaster driven up assistance pledges. *Following the April 2015 earthquake and subsequent aftershocks, Nepal received overwhelming humanitarian support from the international community in its rescue and rehabilitation operations. Subsequently, at the International Conference on Nepal's Reconstruction (ICNR), Nepal received pledges worth US$ 4.1 billion from bilateral and multilateral partners, which reflects the importance of the role played by development partners in the overall economic development of the country (Gurubacharya, 2015).*

Pegged currency and volatile inflation. Nepal's currency is pegged to the Indian Rupee (INR) at the rate of INR 1 equivalent to NPR 1.60. This link to the INR means that the Central Bank of Nepal plays little to no role in influencing the NPR in relation to other convertible currencies. Inflation declined to 7% in 2014/15, the lowest since 2007/08. The inflation rate peaked in 2008/09 and is currently on a decreasing trend (Nepal Rastra Bank, 2015).

Infrastructure context

Transport infrastructure limited to key corridors. The Ministry of Finance's Economic Survey of 2014/15 showed that the country has a total road network of 26,935 km, with a road density of 48 km per 100 km^2. Given that only 43% of the population have access to all-weather roads, the total road network density of Nepal can be considered low (The World Bank, 2016):

- Just under half (11,349 km) of the road system is black topped/tarmac.
- The remaining sections are gravelled (6,192 km) or dirt roads (9,394 km).
- The country's strategic road network – i.e. which provides inter-regional connection and links to regional and district headquarters, international borders, key economic centres and major urban roads, and which forms the core of the country's road system – stretches only 14,490 km (ADB, 2012).

The East–West Highway is the main road link to the Terai region, which facilitates connectivity between Nepal and India in the country's major trading activity.

Nepal has a single international airport (in Kathmandu) and four regional airports, with a second international airport proposed for Lumbini (CAAN, 2012). The country has proposed two additional international airports – at Nijgadh and Pokhara – but the construction process has yet to start (CAAN, 2012).

With regard to rail transport, plans have been initiated under the Railway and Metro Development Project, although they have yet to come to fruition (ADB, 2012).

High demand for electricity not being met through production increment. Approximately 77% of the population have access to electricity for 5+ hours a day.

In the year 2013/14 the electricity production of Nepal increased from 746 MW to 782 MW, and transmission lines were extended. However, the current demand for electricity stands at 1,291.1 MW, resulting in a supply gap of 508.65 MW. This gap has led to an unreliable supply of electricity, with load shedding sometimes reaching 10 hours a day during the dry season, as the majority of the country's hydro-electricity plants are run on a river-based system (Nepal Economic Forum, 2015).

Nepal ranks second in the world in terms of inland water resources. The country is home to 2.27% of the world's water resources. Nepal's hydropower potential is estimated to be 83,000 MW, of which 40,000 MW is considered technically and economically viable. However, the country has not been able to develop even 2% of the feasible capacity. The country's Hydropower Development Plan, with a required budget of US$ 33.61 billion, has set the target of developing 25,000 MW of hydro-electricity within 20 years (Nepal Economic Forum, 2015).

High mobile phone penetration. Telecommunication in Nepal has made significant strides in recent years. Overall, mobile phone subscription has increased by 116% in the past five years, with the penetration rate exceeding 104% in the year 2014/15 (Nepal Telecommunications Authority, 2015). This started from a low base of 39% of the population with mobile subscriptions in 2010/11, rising to 98% in 2014/15.

It is also worth noting that from 2010/11–2014/15 the data services penetration rate increased from 10% to 43% (Nepal Telecommunications Authority, 2015). There is a large disparity in coverage levels between urban and rural areas.

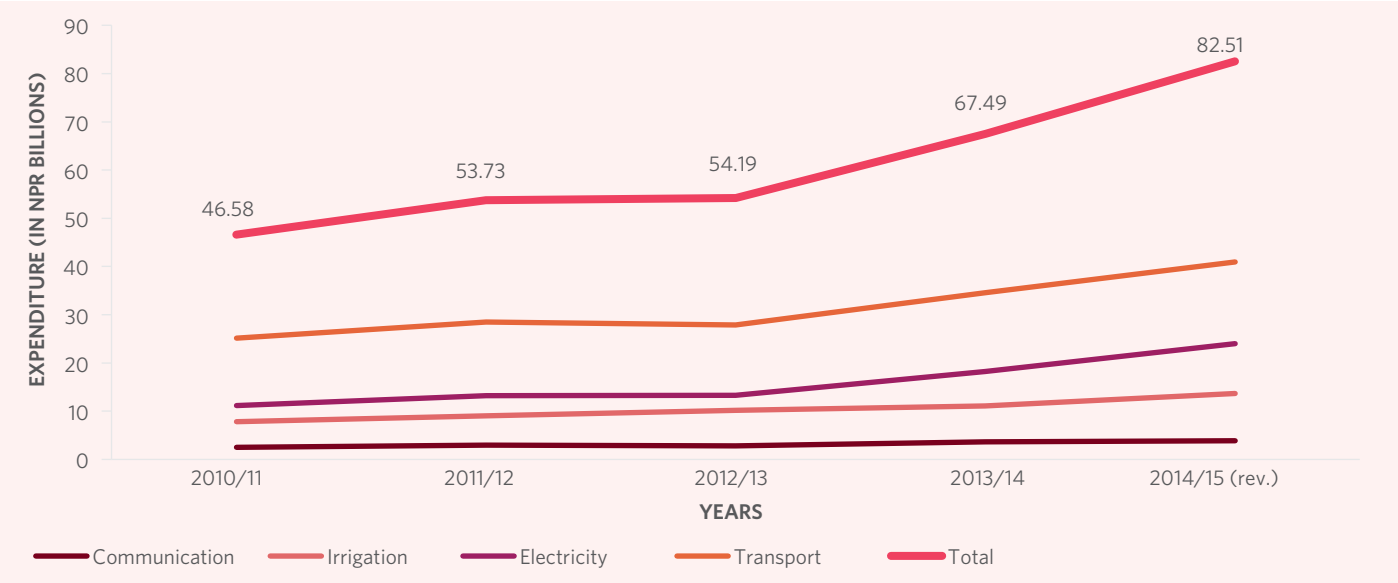


Figure 11: Nepal: pattern of government expenditure on infrastructure (2010/11–2014/15)

Source: Ministry of Finance, 2011, 2012, 2013, 2014, 2015.

Improved but limited and unreliable access to water and sanitation. Around 67% of individuals in Nepal have access to internal water supply (piped or underground), and approximately 78% have access to toilet facilities.

The key reason for exclusion in remote areas is because people have to travel half an hour or longer to access their drinking water. The supply of piped water is also mostly erratic, with water being supplied for only a few hours daily in some areas and on alternate days (or less frequently) in other areas. Moreover, the quality of sanitation facilities is generally inadequate, as people only have access to basic latrines with unsanitary disposal of waste materials (WASH-RCNN, n.d.).

Increased government spending to improve poor infrastructure. In terms of Nepal's poor infrastructure in key areas, the following have been highlighted as the major hindrances to the country's economic growth: unreliable electrical power, and low-quality transportation networks (The World Bank, 2015).

Recognising this, the country has significantly increased its infrastructure spending (as shown in Figure 11.

Regulatory and policy context

Summary

- Policies encouraging financial inclusion and access have been in place since the 1990s.
- The Central Bank of Nepal is proactively mandating the expansion of banking and financial institutions in rural areas to expand their reach to deprived sectors.
- MFIs are being leveraged as effective tools for financial access and inclusion.
- Provisions are in place to support MFIs through low-interest rate wholesale funds.
- The country is undergoing transition, with slow pace of regulatory reform.
- A cumbersome regulatory environment constrains private sector growth.
- The lack of a registry to record collateralised assets complicates the lending process and restricts the ability of MSMEs to secure formal credit.
- 'Shadow banking' and MFI and SACCO governance shortcomings undermine consumer safety/protection and financial access initiatives.

Policy context

Three-year interim plan guides and ensures implementation of the country's strategies. Nepal's Three Year Interim Plan 2013/14–2015/16 is the 13th three-year plan for the country, and the third that is an *interim* one; previously, Nepal adopted five-year plans but, given protracted political transition, the country has shifted to three-year plans.

The core vision of the current three-year plan is for Nepal to graduate from least developed country (LDC) status to developing country status. An average annual growth rate of 6% has been targeted for the country during this period. The priority sectors outlined in the three-year interim plan are:

- Hydro and other energy development.
- Agriculture productivity, diversification and commercialisation.
- Road and other physical infrastructures.
- Social sector: basic education, health, drinking water and sanitation.
- Tourism, industry and trade.
- Good governance.

Given that the financial system of the country is key for development of the country's economy, the interim plan emphasises the sound development of banks and financial systems. In order to achieve the priority sector objectives of the interim plan, specific objectives pertaining to the development of banks and financial system have been included. These include expansion of credit in the private sector, along with increasing development expenditure and overall investment.

Donor-supported financial strategies and policies largely beneficial. Nepal's financial strategies and policies have been greatly shaped by technical assistance from donors. The BFI Act (2006) was also an outcome of the financial sector-strengthening programme supported by multiple donor agencies (ADB, 2014).

There has been a close correlation between development partner policies and the country's financial sector development; most of the financial sector development projects are funded entirely or partially by development partners. This has aided in introducing international best practices in the financial sector regulation, along with enhancing the technical capacity of the regulators. The finance sector reform programmes have improved the governance and capacity of the sector.

The successful implementation of Basel laws and the transformation of the Central Bank of Nepal (NRB) into one of the country's most robust regulatory institutions can be considered among the key positive outcomes.

Although most interventions from development partners have strengthened the sector, there have been instances where these interventions were not successfully implemented.

Financial sector policies

This sub-section considers the following financial sector policies:

- Deprived sector lending directive.
- Financial sector development strategy.
- Financial Intermediation by Societies Act (1999).
- Rural Self Reliance Fund.
- Five-year capital market development plan.

Deprived sector lending directives facilitating access to finance. NRB has issued directives for class A, B and C institutions to allocate 4.5%, 4.0% and 3.5%, respectively, of their loan portfolio to deprived sector lending. ('Deprived sectors' include extremely low-income people, especially socially deprived women, members of lower castes, disabled people, small and marginal farmers and landless people, who, by virtue of their low status, are excluded from formal banking services.) Some BFIs are establishing microfinance subsidiaries, while others have created programmes to meet this requirement.

Banks that do not meet the priority and deprived sector lending targets are subject to fines, which (in compliance with the unified directive issued by NRB to the licensed banks and financial institutions) are calculated by multiplying the shortfall amounts against the highest interest rates that the banks charge to their clients.

Deprived sector lending not proving fully beneficial. Although this directive greatly facilitates financial access to the unserved sector, the deprived sector has not been able to benefit fully due to the flexibility permitted in the implementation of the policy; given that BFIs are allowed to choose between wholesale and retail lending to meet the mandatory requirement, they prefer to give out wholesale loan to MFIs, which have not always proved effective at distributing loans with the required financial inclusion impact.

This raises questions regarding the ability of the existing MFIs to effectively employ all the current funding at their disposal for the benefit of the deprived sector, and the possibility of a more directed lending approach to be undertaken by the class A, B and C institutions. MFIs borrow money at lower directive-based rates and on-lend it with very high spreads. MFIs can determine their own interest rate based on market competitiveness, which makes disbursement of loans more profitable than parking funds at other institutions. It is therefore in the interests of the MFIs to mobilise the available funds. The challenge, however, lies in finding *avenues* for the disbursement of loans, as MFIs are now saturated in regions such as the Terai, where there is greater demand for credit.

In addition, MFIs' work is made difficult by the challenge of duplicate borrowings and lack of individual credit information (information asymmetry) regarding would-be borrowers.

Deprived sector lending directive has failed to take cognisance of MFIs' lending capacity. The outreach of MFIs has not increased commensurately to absorb the constant excess liquidity among MFIs. The monitoring and supervision mechanism of MFIs needs to be strengthened in order to develop MFIs as a robust channel to more effectively facilitate financial inclusion.

Financial Sector Development Strategy promotes an inclusive financial sector. The draft strategy proposed by the central bank will be the overarching strategy of the country for 2015–2020. This includes separate strategies for banking, insurance, the capital market, cooperatives and non-banking financial institutions.

The financial sector development strategy focuses on growth, access and inclusion, stability, governance, infrastructure and capacity development. The main aims of the strategy are:

- To raise the financial sector's direct contribution to GDP to 8%.
- To raise daily turnover in the capital market to NPR 2 billion (US$ 20.29 million) by 2020.
- To modernise the payments system.
- To increase the outreach of financial institutions.

The efficient functioning of the financial system will facilitate the expansion of other sectors of the economy, thereby creating a ripple effect in the economy through diffused benefits arising from the efficiently functioning financial sector. A high-level committee is to be formed to ensure the implementation of the strategy.

Financial Intermediation by Societies Act (1999) was established to pave the way for BFIs to expand into the underserved areas. Under this policy, NRB permitted the establishment of financial intermediary non-governmental organisations (FINGOs), to provide saving and loan services to clients through MFIs. This Act had been instrumental in expanding the reach of financial institutions in rural areas.

With the success of FINGOs, NRB initiated a process to graduate the FINGOs into BFIs and bring them into compliance with the BFI Act (2006). In the Monetary Policy of 2013/14, FINGOs were to convert into class D institutions (i.e. MFIs) by mid-July 2015, with a capital requirement of NPR 10 million (US$ 101,491).

Rural Self Reliance Fund (RSRF) was established to facilitate access. The RSRF (see also Box 12, in the section on the market for credit) was established by NRB and functions as a state-owned lender.

Established in 1991, the fund provides easy credit access to entrepreneurs, and cottage, small and medium enterprises. This fund was established to uplift the economic condition of the deprived sector, who do not have easy access to formal financial institutions. All the borrowers of the fund are based in rural areas, with priority given to the areas identified by the poverty map created by the National Planning Commission (Pradhan, n.d.).

As of FY 2014/15:

- The total seed capital of the fund amounted to NPR 793.4 million (US$ 8.06 million).
- 1,013 loans had been disbursed to institutions.
- 48,679 loans had been disbursed to beneficiary households.
- The disbursed credit amount totalled NPR 1.66 trillion (US$ 16.8 million) (Ministry of Finance, 2014/15).
- The fund had an NPL (non-performing loan) rate of 5.45% (Nepal Rastra Bank, 2015).

Five-year capital market development plan being implemented. The government is currently implementing a Five-Year Capital Market Development Plan, under which improvement of the securities market, effective regulatory arrangements, and the stability and sustainable development of the capital market is being targeted.

Under the same plan, a draft security market reform and development strategy is being prepared. This plan will be incorporated into the upcoming Financial Sector Development Strategy. A draft document on Commodities Derivative Market acts has been prepared, with its regulatory process currently under way (Ministry of Finance, 2015/16).

A better-functioning securities market will be crucial in the development of the insurance market and will help to drive longer-term financing as well as the aggregation of capital.

Regulatory framework

Long bureaucratic process makes the regulatory framework cumbersome. Private sector businesses in Nepal must comply with 130 processes under 41 ministries and government agencies (The World Bank, 2015). At the same time, the regulatory process is characterised by a high degree of informality. Private sector businesses are reluctant to accept regulations and inspections, and rather seek ways to navigate around the bureaucratic process. The burdensome regulatory approach has led to a culture of non-compliance, and an inability on the part of the authorities to enforce and implement regulations.

Concerns linger regarding how the newly adopted constitution will be implemented. Nepal promulgated its new constitution in September 2015 with efforts to embrace a republic, federal, democratic, secular and inclusive state. However, this was met with resistance from the Tharu and Madheshi parties. There is uncertainty regarding both how the main political parties will address the issues of these resisting parties, and how the concerns of India and China will be incorporated into the country's constitution. Furthermore, the adopted constitution does not yet have a detailed implementation plan.

Supervisory landscape

Figure 12 shows the supervisory landscape and various financial institutions of Nepal.

The Central Bank of Nepal (NRB) oversees banks and financial institutions. The Ministry of Finance (MoF) is the central governing authority responsible for overarching economic and financial matters within the country. Nepal Rastra Bank (NRB) – the Central Bank of Nepal – comes under the jurisdiction of the MoF.

NRB functions as the monetary, regulatory and supervisory authority of banks and financial institutions (Nepal Rastra Bank Act 2002). Under NRB's mandate, any communication by the Government of Nepal with NRB and vice versa needs to be made through MoF. Furthermore, NRB's board includes the secretary of MoF. The Recommendation Committee formed for the appointment of the governor of NRB is also chaired by MoF.

The Insurance Board oversees the insurance industry. The Insurance Board, known locally as '*Beema Samiti*', is an autonomous body, established with the mandate of systematising, regulating and developing insurance business in Nepal. It was established under the Insurance Act (1992) and is responsible for framing policies and providing suggestions to the government regarding the insurance sector. It also issues necessary directives to the insurers and works for the protection of the general interests of the insured. Currently, there are 9 life and 17 non-life insurance companies under its jurisdiction.

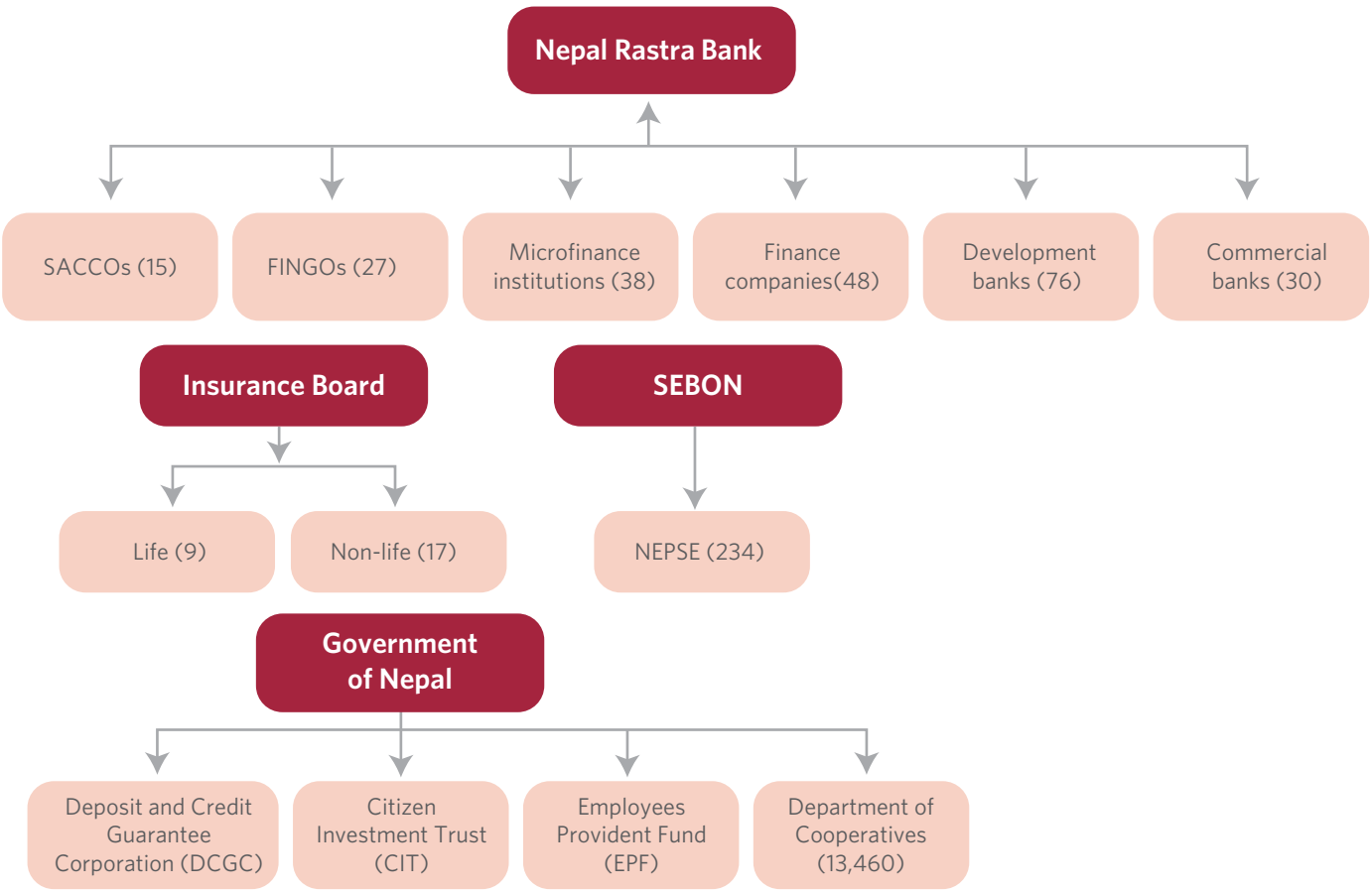


Figure 12: Supervisory landscape (as of October 2015)

Supervision of cooperatives is dependent on where the cooperative was registered. The Department of Cooperatives, established under the Ministry of Planning, Development and Agriculture, is responsible for the supervision of cooperatives registered under the department. It was established with the goal of developing cooperatives as the foundation of the economy. Currently there are 13,460 SACCOs and 4,031 multi-purpose cooperatives under its jurisdiction.

However, previously NRB also used to register saving and credit cooperatives, and there are thus 15 cooperatives under NRB's jurisdiction. There is no overlap of jurisdiction between the NRB and the Department of Cooperatives, and consequently NRB has no direct control of the financial aspects of cooperatives not registered with it, and vice versa.

Only one securities exchange, regulated by a government-owned body. The Securities Exchange Board of Nepal (SEBON) supervises the activities of Nepal's stock exchange (NEPSE). SEBON constitutes representatives from the Ministry of Finance, Ministry of Law, NRB, Federation of Nepalese Chambers of Commerce and Industries, Institution of Chartered Accountant, an expert member and a government-appointed chair. SEBON is the apex regulator of the securities market under the Securities Act (2007), in terms of which it regulates and manages the activities of the securities markets and persons involved in the business of dealing in securities.

Different government organisation-regulating institutes that support financial services. The government's various ministries oversee the functioning of three institutes:

- The *Citizen Investment Trust* (CIT) – a semi-government savings and investment institute involved in savings, investment, merchant banking and market-making.
- The *Employees Provident Fund* (EPF) – which manages the provident fund in Nepal for government, public and private sector employees.
- The *Deposit and Credit Guarantee Corporation* (DCGC) – a deposit-insuring organisation responsible for credit guarantee and deposit guarantee.

Regulatory issues to be considered

Slow regulatory reform. NRB, the central bank, has the authority to license, regulate and supervise BFIs. Previously, BFIs were licensed and regulated by multiple laws, in terms of which government banks were established and regulated under their own separate Acts, while other commercial banks were governed by separate Acts. The Commercial Banks Act (1974), Development Bank Act (1996) and Finance Company Act (1985) were the governing Acts. These were later (2006) merged into a single BFI Act.

The process of consolidating and replacing the separate Acts and promulgating an overarching Act took more than two decades; the reason for this lengthy process was mainly the political transition of the country: during the transition, the promulgation of the new constitution was made a priority and other Acts were placed on the back burner.

Country undergoing long transition. Nepal is still undergoing political transition and has only recently adopted a new federal democratic republican constitution.

Although reform bills are being tabled in parliament, the approval process has been stalled as parliament has not been able to deliberate on the reform of banking laws and proposed legislation (Louis Berger, 2014). Table 4 lists the proposed new Acts and amendments.

Collateral-based lending curtailing ability of businesses to secure loans. The banking regulations allow BFIs to extend loans against movable assets, immovable assets, fixed accounts or other acceptable guarantees. However, in practice BFIs show preference for physical collateral – especially land and buildings – so as to better mitigate the risk. This practice restricts projected cash flow-based lending. Since small businesses rarely own immovable assets to secure loans, their ability to access credit is restricted. Furthermore, in terms of Unified Directive 2072, NRB has directed the category 1 banks to create loan loss provision of 20% on loans that are only backed by personal and institutional guarantee. This requirement discourages banks from providing loan to small businesses that are unable to provide physical collateral.

Lack of registry to record collateralised assets complicates lending process. The government promulgated the Secured Transaction Act in 2006 with the aim of creating a registry of collateralised movable and intangible assets. However, the registry has never been established.

The lack of a registry to record loans on movable assets discourages the use of such assets as collateral, because BFIs are not able to ascertain whether a movable asset has been pledged to another institution. Since Nepal has a weak property registration system, mitigating such risk increases the cost of borrowing (Louis Berger, 2014). The establishment of a public registry will provide a basis for ascertaining the hierarchy of competing claims on assets.

Detailed KYC requirement discouraging MSMEs from entering formal banking channels. Under Nepal's anti-money laundering and combating the financing of terrorism (AML/CFT) moves, NRB had introduced a know your customer (KYC) requirement for deposit taking, remittance, cross-border transaction and credit extension activities, which is then cross-verified internally by the banks. Only low-risk clients with transaction less than NPR 100,000 (US$ 1,015) in annual deposits and withdrawals are eligible for simplified KYC requirements. At such low thresholds, MSMEs are discouraged from entering banking systems, as their annual transaction would exceed NPR 100,000 (US$ 1,015), requiring them to fulfil the detailed KYC and thereby acting as an access barrier.

KYC requirement has had different impacts. On the one hand, the introduction of this provision has directed customers towards informal lenders, where such documentation is not required. On the other hand, it has resulted in significant improvement in the

Acts	Proposed revision	Status
Banks and Financial Institutions (BFI) Act (2006)	Focuses on corporate governance. Strengthens systems safety and soundness. Grants increased power to NRB for supervisory oversight. Incorporates provisions for merger and acquisition. Streamlines liquidation processes. Provides for establishing an Infrastructure Bank.	Act returned to NRB for further review.
Nepal Rastra Bank Act (2002)	Focuses more on public credibility of the entire banking and financial system of the country.	Under revision.
Banking Offence and Punishment Act 2064	This is a revision to the existing Act.	Under discussion in parliament.
Cooperatives Act (1991)	Establishes a robust system for monitoring and supervision.	Draft Act returned to Department of Cooperatives for review and amendments.
Insurance Act (1992)	Establishes provisions for improved governance of micro-insurance institutions. Regulates reinsurance.	Under revision.
Deposit and Credit Guarantee Act	This is a new Act drafted with the aim of facilitating deposit insurance and credit guarantee programme. Provides a legal framework for deposit insurance.	Under review by government.
Nepal Payments System Development Strategy	This is a strategy to establish a National Payments System (NPS). The system would allow direct transfer of funds between financial institutions.	NRB has established a new department to oversee the country's payments system.

Table 4: Proposed new Acts and amendments

Source: Authors' own based on stakeholder interviews and Louis Berger Access to Finance for the Poor Programme – Legal and Regulatory Review 2014.

implementation of AML/CFT. Moreover, Nepal is no longer in the grey monitoring area of the Financial Action Task Force (FATF).

Loan duplication from MFIs and cooperatives remains unabated due to lack of overarching Credit Information Bureau. Nepal's Credit Information Bureau only covers class A, B and C institutions. MFIs and financial cooperatives (SACCOs) do not have access to a customer credit information database, making it a mammoth task for these institutions to analyse individual credit risk and avoid duplication.

The Credit Information Bureau only covers loans larger than NPR 1 million (US$ 10,149). Financial fraud and irregularities are not uncommon at the MFI and SACCO level for this reason.

The regulatory authorities have acknowledged this problem in cooperatives, and a common database system called Finsys has been developed and is in the process of national implementation. Considering the large number of cooperatives and the degree of technical skill required to operate the Finsys system, however, full implementation will likely take a long time.

Large number of financial institutions makes monitoring a challenge. As of 2014, there were 250 banks and non-bank financial institutions licensed by NRB. The bank's supervision department conducts on-site examination, special inspection, targeted inspection and monitoring inspection. However, the sheer number of banks makes regular inspection a daunting task.

NRB adopts a risk-based supervision approach and updates the risk profile of banks for supervisory purposes, as well as conducting in-depth inspection of selected banks. Although these institutions are regulated, the risk of problematic institutions poses a significant threat to the economy. The ongoing consolidation of banks would result in an increased capital base and a reduced number of institutions, which would in turn enable NRB to carry out more effective monitoring.

Regulation on bank network expansion creating duplication and encouraging concentration of BFIs in a single area. The regulation on expansion of bank networks was introduced in a scenario where the number of banks was increasing and their activities were mostly concentrated in the urban centres. Recognising

that a good concentration of wealth outside of Kathmandu was going unserved, this policy was mandated to encourage banks to explore the feasibility of other markets. Although the policy was introduced with the intention of restricting unfair market share and the concentration of BFIs in urban areas, it has, however, been seen to be impeding free market practices. For example, BFIs are only permitted to open one branch within Kathmandu Valley if they have opened three branches outside the valley; and, of those three, one must be in one of the 14 priority districts identified by NRB, and another must be outside the district headquarters. This has resulted in BFIs establishing branches on the outskirts of urban areas where the location of the branch is technically in a rural area but the branch is serving the urban population. Similarly, in rural areas, most of the BFI branches are concentrated in and around market centres, thereby defeating the purpose of the mandatory requirement of opening of rural branches to serve the unserved population.

In the context of rural areas, the priority is access to finance rather than high spread. This policy, however, does not restrict the expansion of remote banking in areas where a bricks-and-mortar branch is not feasible. The central bank has been encouraging agent and remote banking approaches, although the general user tends to perceive a physical branch as being more credible.

Shadow banking and MFI and SACCO governance issues threatening stability. Informal ('shadow') banking activities are widespread, in rural and urban areas alike. Lack of appropriate regulation and monitoring has fostered shadow banking activities in the form of hundis and dhukuti. Moreover, SACCOs and MFIs, which are regarded as the driving agents of spreading financial access, are marred by governance issues in the form of high levels of financially fraudulent activities and irregularities. Timely monitoring and supervision of this segment is crucial to ensure access and financial stability in the country.

Lack of strong customer protection provision. Although the Consumer Protection Act was introduced in 1998, the implementation of the Act is not effective. There is a low level of awareness and low utilisation of consumer protection rights in the country. Consumer protection is mostly limited to theory, with inconsistent and contradictory guidelines being issued. NRB's five-year strategic plan (2012–2016) has a client protection element in the form of expanding existing coverage of deposit guarantees to protect small depositors. In terms of the plan, NRB is working to enhance the institutional framework for the deposit guarantee system and increase the coverage and limit of deposit and credit guarantee. Although the central bank has issued directives in line with the promotion and implementation of consumer protection, there is low awareness of the role of customers with regard to ensuring implementation of customer protection, and the system for handling grievances is inefficient.

Product markets

The market for payments

Summary

- Nepal is a predominantly cash-based economy in which usage of cash is prevalent and preferred, mostly due to convenience and social/cultural acceptability.
- Lack of banking infrastructure in rural areas forces end users to withdraw cash in bulk and use cash for all transactions, large and small alike.
- Incomes are mostly paid in cash across all target market segments, and the same is true for payments of the other goods and services.
- Although the uptake of electronic banking is increasing, general awareness of banking services is low across the target market segments.
- Government is the largest payment user in the country and, as such, can promote usage of digital channels to decrease costs and to introduce users to such channels.
- Banks are the primary providers of non-cash transaction services and are also the most trusted providers.
- Agent banking is a widely accepted concept among providers in Nepal, and the model could be used to tackle the country's geographical challenges.
- The ease of usage of 'other formal' (non-bank formal financial institutions) channels has increased their uptake. Moreover, the proliferation of agents and the interaction and support they offer make these payment channels more appealing and accessible to consumers.
- Usage of informal channels for payments is low, with *hundis* being the main channel of informal money transfer. However, given the large number of undocumented migrant workers, the usage of informal channels continues.
- Mobile financial service providers (MFSPs) in Nepal are led neither by banks nor mobile network providers but by third-party service providers.
- Private MFSPs are venturing into agreements with business and government to distribute welfare and other payments.
- MFSPs are built around isolated/closed systems that are not interoperable. The lack of interoperability hinders the creation of value for end users.
- The cost of digitisation is high for BFIs and merchants, giving them little incentive to expand digital transactions. In turn, the lack of volume of digital transactions has cost implications, making it difficult to justify investment in payment infrastructure.
- Nepal has a very underdeveloped payment system, with the central bank only recently establishing a Payment and Settlement Department to oversee the payments market.
- Nepal's payment system requires forward-looking regulation that establishes clear grounds for BFIs to operate.
- Financial awareness on the part of consumers is key to increasing the adoption and usage of payment channels. Moreover, the benefits and security of carrying a card should be higher than the value of carrying cash so as to increase the adoption of digital channels.

Context

Nepal is a highly cash-based economy in which usage of cash is prevalent and preferred, mostly due to convenience and social/cultural acceptability. Furthermore, the country has a very underdeveloped payment system, with the central bank having only recently established a Payment and Settlement Department to oversee the payments market.

FinScope (2014) has shown that:

- 64% of the adult population use cash and other similar means (such as exchange and barter) for transactions.
- Only 36% use banks for transactions.
- In terms of remittance, 66% remain excluded, while formal payment usage stands at 8% for banks and 19% for other formal channels.

A self-perpetuating cash ecosystem. Cash in circulation in developing countries typically amounts to around 9% of GDP (*The Economist Online*, 2012). With cash in circulation at 16% of GDP in Nepal, the prevalence of and preference for cash is clear (Nepal Rastra Bank, 2014). The abnormally large amount of cash in circulation in Nepal creates a self-perpetuating cash ecosystem.

Furthermore, the lack of banking infrastructure in rural areas forces end users to withdraw cash in bulk and use cash for all transactions. The MAP qualitative study (2015) showed that (for a range of reasons) there is a lack of general acceptance of electronic payments for transactions, resulting in both payer and payee seeking to transact in cash:

- For retailers, the use of point of sale (POS) is a hassle, as they need to pay additional commission to the bank; because of this, retailers prefer to give discounts on cash transactions because no fee is levied for bulk cash deposits. This applies mainly to small merchants with a low volume of transactions, who have to pay POS fees (usually amounting to 2%–4% of the transaction, depending on the bargaining position of the merchant).
- The culture of evading value-added tax (VAT) payment also acts as a barrier to adopting digital payment mechanisms. In

2012, 468 firms were investigated for VAT fraud scams and a total of NPR 4.55 billion (US$ 46 million) was levied in fines on those found to be producing fake invoices (*The Himalayan Times*, 2015).

- Even when business entities accept electronic means of transaction, the reliability of such services, especially in the case of small retailers and service providers, appears to be low.

Generally, retailers and customers alike are wary of using electronic means for transaction of small amounts, preferring cash as a payment mechanism.

"At the end of the day, I prefer to get paid in cash for the number of trips I did. I can buy vegetables on my way home." (Boat rower, female, aged 48)

"If I go to the market, the shopkeeper will ask for cash. I do have a mobile banking account but the shopkeeper won't accept it so I have to use cash." (Salaried worker, female, aged 37)

"I need cash on an everyday basis. I need to give lunch money for the children, money for transportation and other daily expenses. It is convenient for me to hold on to cash." (Dependant, female, aged 52)

"I do all my transactions in cash. My transaction generally involves a small amount so there is no need to use cheque or cards." (Rickshaw puller, male, aged 42)

"Even though I have two debit cards, I still carry enough cash when visiting a restaurant as there have been many instances where they did not accept cards due to some or other technical error or lack of electricity backup. This becomes really inconvenient if I am not carrying cash, so I prefer to always carry enough." (Salaried worker, female, aged 28)

What payments are made, and how are they made?

The different payment categories and their relationship to cash

Table 5 shows the prime payment categories in the country.

Salary payments (G2P, D2P, B2P, P2P). Salary payments to individual employees from their employer, which could be a business, an individual, a donor or government, are regular, consistent bulk payments.

Only 10% of the total adult population use bank accounts to receive salary or wages, while the vast majority (i.e. 81%) still get paid almost exclusively in cash:

- Given the large size of the 'shadow economy' in Nepal, it becomes difficult to mandate all salary payments via formal channels.
- In Nepal, salaried workers make up 10% (1,415,766) of the total adult population. Of these salaried workers, only 23% (319,073) receive their salary through direct bank transfers; 8% (113,440) receive their salary by cheque; and 67% (952,115) receive their salary in cash.

Remittance (P2P). Around 11% of Nepali adults rely on remittance as their primary source of income, while 19% consider remittance an additional source of income. Nepal has a large migrant population, who remit money to family members in rural and urban areas of the country. Of the adult population, 52% send remittance to their parents, who are generally dependent on the remittance income. In all, 24% of the adult population in Nepal receive international remittance (FinScope, 2014) – 27% of that from Malaysia. Of total outbound remittance, 33% is sent to India. Since 24% of remittance receivers are banked and 56% use other formal payment channels, the usage of money transfer agents for remittance is high.

Bill payments (P2G, B2B, P2B, D2B and G2B). Bill payments constitute settlement of accounts in respect of goods or services. Bill payments can include payments for water, electricity, airtime, groceries, pre-paid services and school fees. Moreover,

		PAYER			
		Government (G)	**Donor (D)**	**Business (B)**	**Person (P)**
PAYEE	**Government (G)**		Grant disbursement Tax	Tax	Tax Bill payments Spot payments
	Business (B)	Procurement Bill payments	Procurement Bill payments Grant disbursement	Bill payments Spot payments	Bill payments Spot payments
	Person (P)	Salaries Social benefit transfers	Salaries Social benefit transfers	Salaries	Salaries/wages Remittance

Table 5: Payment grid – categories of payment in Nepal

payment to financial service providers in the form of loan repayment and insurance premiums can constitute a type of bill payment. Some of these settlements are done in cash while some target market segments make use of cheques and bank transfers.

Spot payments (P2B, P2G, B2B). A spot payment constitutes the payment by a person to a business in return for a good or service and is made at the point at which delivery is taken of the good or service. Such payments are made immediately for the transaction and fulfilment, accompanied by the handover or control of goods/services. In Nepal, with the exception of a few big shopping malls, service providers – e.g. small shops, grocery stores, restaurants and others – rarely accept cards, cheques or mobile money. The spot payment market is largely governed by cash transactions because users and providers alike are hesitant to use electronic channels for small payments.

Social benefit and welfare transfers (G2P, D2P). Social benefit and welfare transfers are the payments of grants, incentives and allowances paid by the government and/or donors to eligible recipients. These transfers can also include consistent bulk payments. The central bank provides payment services to the government through its central office and seven regional office. In other areas, such services are provided by Rastriya Banijya Bank. The government currently provides welfare payments under five different social protection programmes with almost a million citizens in total. Furthermore, agencies such as the United Nations have programmes that involve distribution of cash to specific target markets. The profile of recipients can vary greatly. Given the country's geographical constraints, in addition to the difference in profile of recipients, the channel of payment varies, because isolated rural areas rarely have the presence of BFIs and MFIs. Disbursement to welfare recipients is currently done mostly in cash by the Ministry of Federal Affairs and Local Government, although the Ministry is looking into electronic payment options.

Tax payments (B2G, P2G). Tax payments for the most part involve the target market segments salaried workers and MSMEs, who are required to pay income tax on salaries and VAT on goods and services sold. Income tax constituted 4% of national GDP, and VAT 5.2% of national GDP in 2013/14. Income tax contributed 25% and VAT contributed 32% of the total revenue collection in 2013/14 (IRD, 2013/14). The Inland Revenue Department (IRD) has implemented an online revenue accounting system, enabling taxpayers to submit their tax returns electronically. However, the system is limited in that the payment procedure is bureaucratic and cumbersome and actual tax payment online is not accepted.

Procurement (G2B, D2B). Government and donors follow set criteria when procuring goods and services for which tenders are taken out. The criteria surrounding government and donor procurement payments are important for the eligibility of MSMEs to win these tenders and deal with the particular type of banking facilities. Currently, the Ministry of Finance, through its financial management information system, generates cheques for payment of government creditors through District Treasury Offices. Nepal's Income Tax Act (Section 21 of Income Tax Act 2002 (2058) mandates the use of cheques for all transactions greater than NPR 50,000 (US$ 507). Similarly, the central bank mandates the use of direct bank deposit for transactions of more than NPR 5 million (US$ 50,746) (Directive 23, Point 23 (2072). This encourages the use of formal financial channels and improves financial integrity. The system of checks and balances adopted by the government bodies in Nepal requires multiple authorities to validate the payment, which is generally made in the form of a cheque requiring multiple signatories.

The different payment channels

Channel	Explanation
Cash	Cash is handed over as payment.
Cheque	Payment is made by cheque.
In kind	Payment is effected by trading or bartering (e.g. farm produce, labour etc.).
Electronic banking – also referred to as 'digital banking', 'mobile banking', 'mobile money'	This includes a range of payment options, including: use of the Internet for banking, use of a mobile phone for banking, use of bank card services (e.g. debit, credit), use of a prepaid card, use of an ATM, branchless banking (through an agent).
Other	This includes payment on credit, on tab or on book.

Table 6: Payment channels

How are payment products and services currently being used?

Banks predominant channel of payment, with remittance receivers having the highest uptake. Of the Nepali adult population, 54% use payment services; formal channels are the preferred channels, with usage through banks standing at 70% and other formal channels at 21% (FinScope, 2014).

Note:

- In the current analysis, payment *products and services* refers to all *non-cash* mechanisms for making payments.
- Equally, *exclusion* from usage of payment services does not mean the people in question are not making payments (e.g. in cash, through barter or exchange etc.), but that they are not using any of the following mechanisms to do so: bank, other formal financial service provider, informal service provider, family and friends.
- By *informal* payment channels is meant the use of a payment *service* – albeit an informal service. That said, informal payments channels are used by only a negligible portion of the target market segments.

In terms of exclusion from payment services: the dependent and irregular earners target market segments remain largely excluded from usage of payment services (at 58% and 68% excluded, respectively); salaried workers, despite being the highest banked segment, show 26% exclusion from payment

services; and, by contrast, only 9% of the remittance receiver target market segment are excluded from the usage of payment services (see Figure 13).

In terms of uptake of payment services: salaried workers are the largest users of banks for transaction services at 64% (899,433 people), while usage of other channels for transactions is very low across that target market segment. Interesting to note is that 13% of the farmers target market segment use 'other formal' channels for payments, and that the uptake of 'other formal' channels is comparatively high for the remittance receiver target market segment (28%).

Not surprisingly perhaps, those in the remittance receivers target market segment are the highest users of banks for remittance, at 19% (303,016 people).

Salaried workers the greatest users of transaction accounts. Figure 14 depicts usage of transaction accounts. Salaried workers have the highest uptake of transactions through formal channels. The majority of the adult population use bank accounts for saving purposes (71%), and a large percentage (40%) use bank accounts to keep their money safe. Although only 18% of Nepali adults are excluded from access to financial services in general, the exclusion from transactions is strikingly high: 64%. Irregular earners register the highest exclusion (80%), followed by dependants (73% exclusion).

Receiving income: mostly done in cash. As shown in Figure 25, cash is the predominant channel of income payment for all target market segments, followed by bank account. Dependants (88%), irregular earners (87%), MSMEs (86%) and farmers (82%) transact mostly in cash. Cheque transaction (1.87%) has lower uptake than in-kind transaction (i.e. trading or bartering), which has 4.35% usage.

Payment for expenses: mostly done in cash. Payments are also for the most part done in cash. As shown in Figure 15, cash is used for most of the expenses incurred by Nepali adults. The highest usage of debit/credit card is for the purchase of clothing and footwear (3%). The usage of cards, mobile money, agent banking, and bank transfers is still very low. (Agent banking is where a licensed individual provides branchless banking services – through the use of smart card or magnetic card from point of transaction machines – on behalf of a licensed FSP.) This further underscores the point already made: that Nepal is a highly cash-based economy, where daily expenses, utility payments and other expenses are mostly paid in cash.

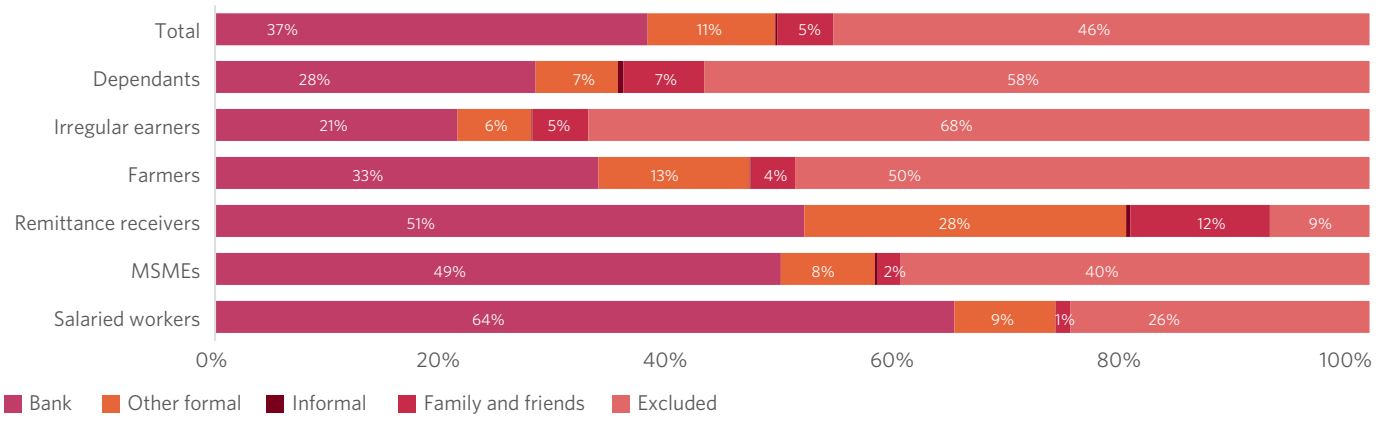


Figure 13: Payment access strand across target market segments

Source: FinScope, 2014.

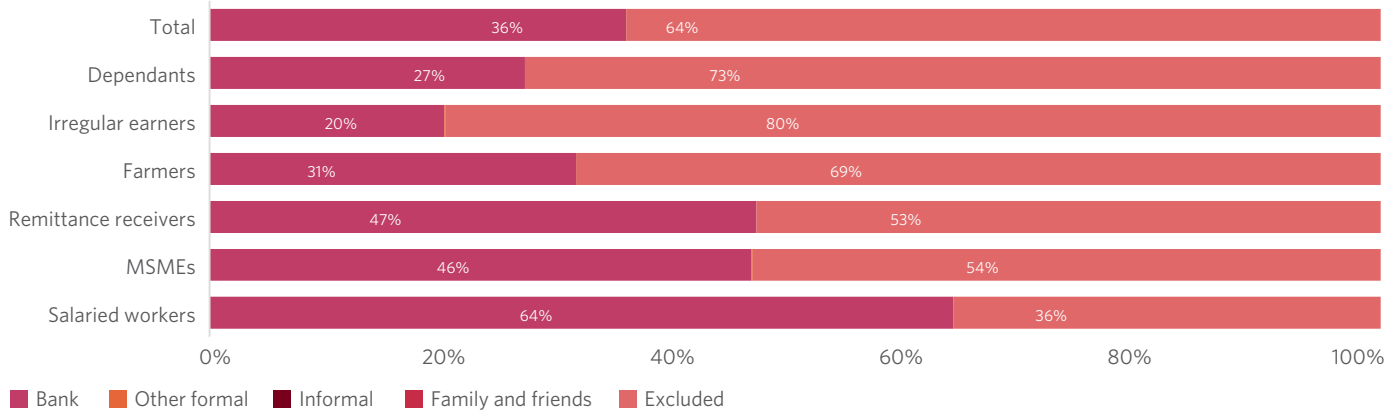


Figure 14: Transaction access strand across target market segments

Source: FinScope, 2014.

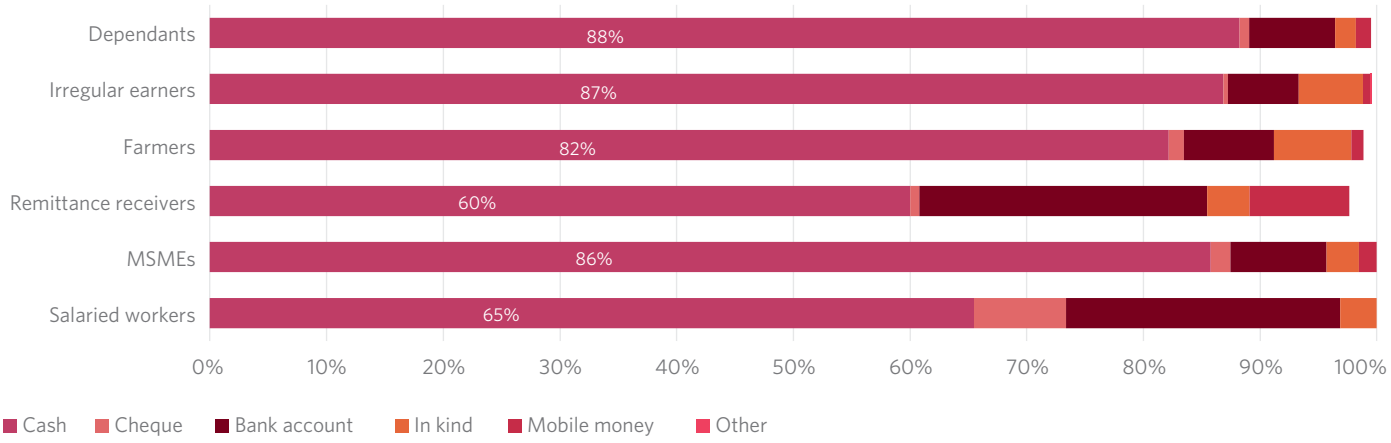


Figure 15: Usage of payment channels for receiving income across target market segments
Source: FinScope, 2014.

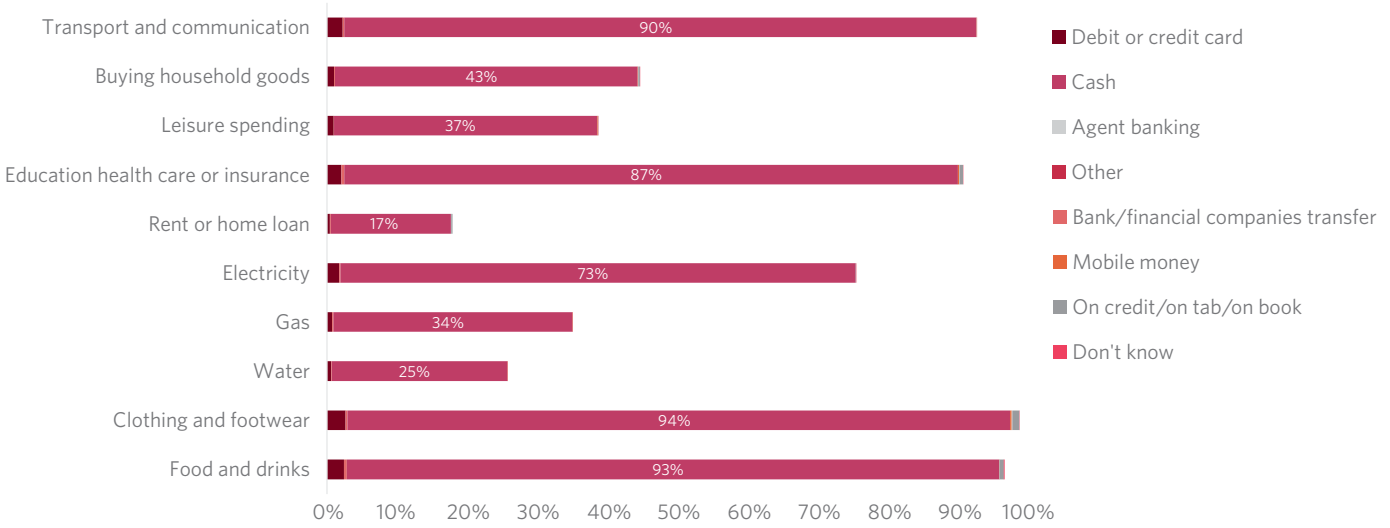


Figure 16: Usage of channels for payments across target market segments
Source: FinScope, 2014.

Comparing the usage of payment channels for receiving income (Figure 15) with the payment channel for paying for expenses (Figure 16), we see that the usage of cash is dominant for both – *but is higher for payment of expenses than for receipt of income*. This further highlights the overwhelmingly cash nature of the payments ecosystem. This also shows that bank accounts are being used as 'mailboxes', simply as a means of receiving funds, which are then immediately and almost entirely withdrawn as cash. Two issues are worth noting at this point:

- Were *more* people to receive their income into a bank account (as is proposed) rather than in cash, it would be even more pressing for the required encashment infrastructure to be in place and ubiquitous (i.e. locally available) – rather than requiring recipients to travel from rural areas to urban areas or rural market centres to access the bank branch, an ATM or a branchless banking agent (who in any case needs access to cash in order to disburse salary payment).
- The fact that cash is more dominant for payment of expenses than for receipt of income indicates a lopsided bank account/card use case, where *retail payment infrastructure* is the key sticking point for effective access.

Uptake of electronic banking is increasing. As shown in Table 7, the uptake of electronic banking in Nepal is on the increase (mid-July 2012–mid-July 2014). NRB recognises five products as electronic banking: Internet banking, mobile banking, card services, ATMs and branchless banking. We see that in the past few years the number of mobile banking and Internet banking customers has witnessed tremendous growth. Similarly, the uptake of debit cards has greatly increased. Nepali adults have been slow to accept credit cards and prepaid cards but in recent years this has started to change. Despite the increase, though, FinScope data shows that only 7% of adults have debit/ATM cards, while 91% have never had a card. This reflects a great potential for usage of card services to grow in Nepal (assuming that current barriers can be addressed).

Particulars	Mid-July 2012	Mid-July 2013	Mid-July 2014
Branchless banking centre	74	205	504
Branchless banking customer	76	30,383	151,066
Mobile banking customers	163,246	452,909	468,424
Internet banking customer	144,763	286,732	328,434
Debit card holder	2,355, 976	3,193,137	3,641,960
Credit card holder	27,921	38,587	57,898
Prepaid card holder	46,083	57,453	66,204

Table 7: Trend of electronic banking in Nepal (2012–2014)
Source: NRB, 2014 (Annual Bank Supervision Report).

Uptake of banking via mobile phone increasing – but awareness very low. The FinScope survey shows that, in Nepal, 96% of adults are not aware of mobile banking as a payment option, and 86% are not aware of agent banking. NRB has identified that under 'mobile banking', Nepali banks are providing services such as balance inquiry, mini statement, last transactions information, withdrawal alerts, cheque book inquiry/request, intra-bank fund transfer and utility bill payments. Nepal has high mobile phone penetration. Yet FinScope shows that 98% of Nepali adults have never had Internet banking, mobile phone banking or mobile money.

Urban dwellers have better access to payments. As shown in Figure 17, urban dwellers have greater access to formal payments channels, with 54.1% (1,597,195) of urban adults accessing payments through banks compared to only 33.5% (4,174,536) of rural adults.

In terms of exclusion from payments services, the rural adult population is the most excluded, at 48.4% (6,036,796) excluded – compared to 38% (1,121,670) of urban adults.

Gender difference in access to formal banking – and thus access to payments. FinScope has shown that in Nepal the male population (44.4%) has better access than the female population (53.3%) to formal banking. It should be noted that the female population has almost equal access (11.2%) to 'other formal' channels as their male counterparts do (11%) (see Figure 18). This is partly driven by the proliferation of cooperatives, which has greatly improved the access to finance for the female population (Khatiwada, 2012).

In terms of world regions, South Asia has the largest gender gap, with only 37% of women having a bank account – compared to 55% of men (The World Bank, 2015). Compared to the rest of South Asia, the female population in Nepal lags behind in terms of access to banks (only 33.4%).

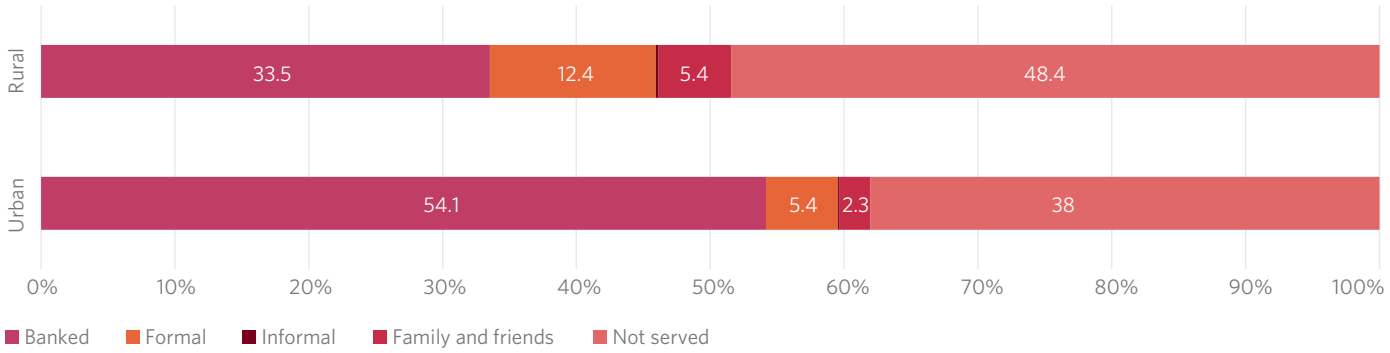


Figure 17: Rural/urban payments access strand
Source: FinScope, 2014.

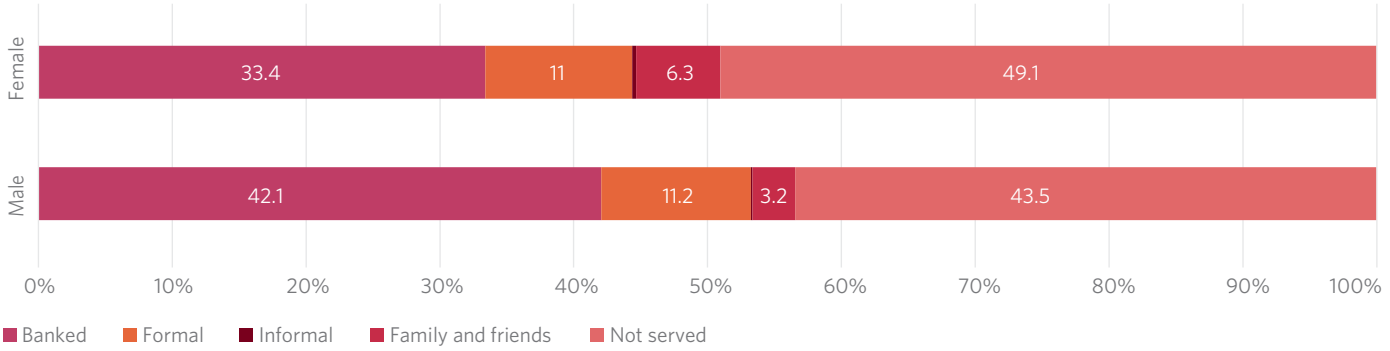


Figure 18: Gender difference in access to payments

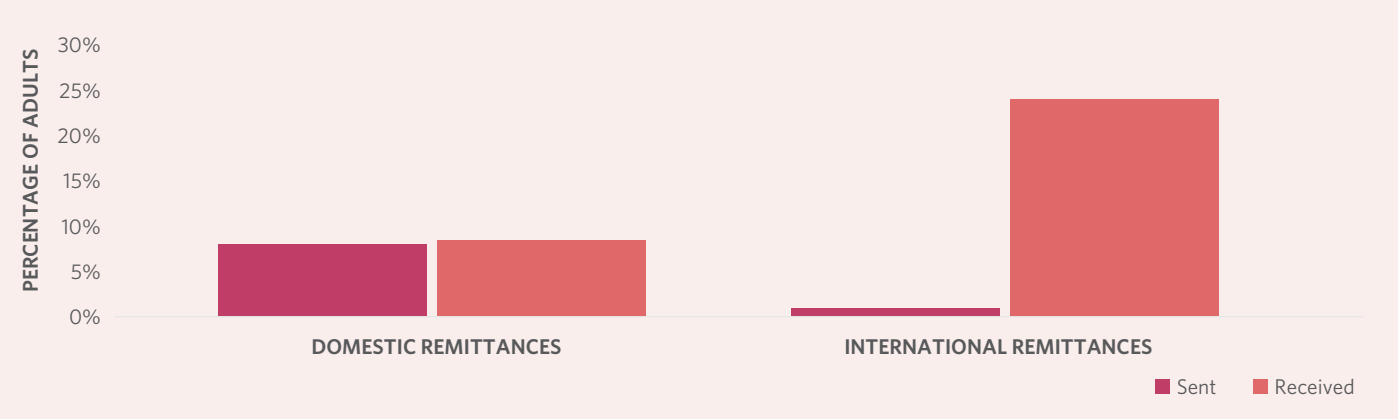


Figure 19: Comparative portion of domestic and international remittance sent and received
Source: FinScope, 2014.

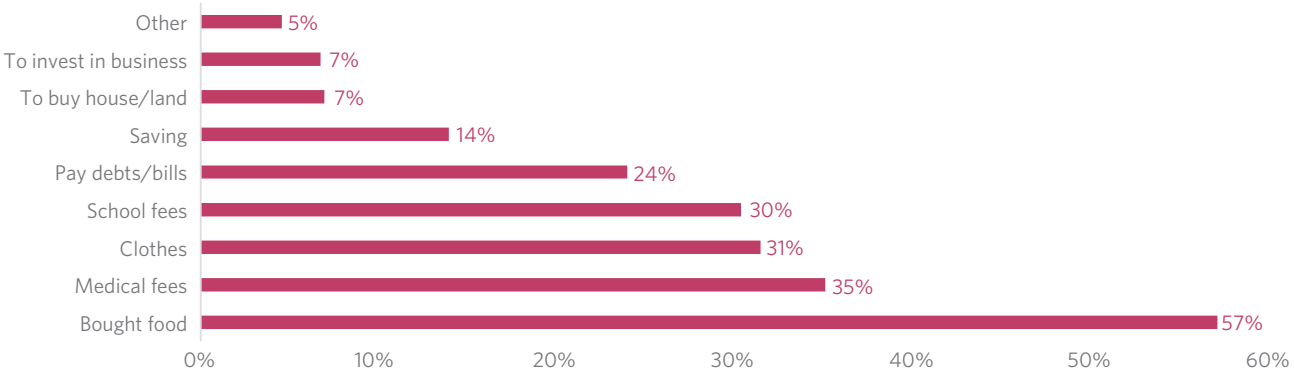


Figure 20: Usage of remittance money received
Source: FinScope, 2014.

International incoming remittance largely dominates the remittance scene. Figure 19 shows that a larger portion of adults that receive remittance obtained funds sent from international markets (24%), while only 1% of adults send remittance outside of the country. Around 30% of adults receive remittance, while 8% send remittance. In 2013/14, Nepal received NPR 589.5 billion (US$ 5,982) in international remittance. World Bank data shows that Nepal ranks third in terms of contribution of remittance to GDP.

In terms of domestic remittance, the proportion of senders and receivers is almost equivalent. The MAP qualitative survey showed that people living in rural areas remit money to their children studying in urban areas or other districts. Similarly, the income earners of the family who are working outside their home district remit money home on a regular basis. This implies that domestic remittance is mostly done with the purpose of maintenance of dependants.

Remittance receivers mostly spend on consumption. Figure 20 shows that 57% of Nepali adult who receive remittance spend the money on buying food. That is to say, although Nepal receives a large amount of remittance, the money is not being used in the productive sector:

- Only 14% save the remittance money.
- Only 7% use it to buy land or a house.
- Only 7% use it to invest in business.

The prime usage of remittance income is for the daily maintenance and health of the family. This implies that a significant section of the population relies on remittance as their social security net. (Of the adult population, 11% have remittance as their primary income and 19% rely on remittance as an additional source of income.) This emphasises the social importance of developing this payment modality so as to facilitate easy, affordable and reliable access to payments on the part of remittance receivers.

Remittance inflows and outflows are largely irregular. Nepali adults send and receive remittance on a very irregular basis, with 19% sending and 18% receiving remittance on a monthly basis. More than 90% of Filipinos and Indonesians were found to send money to their home country on a monthly basis (ADB, 2006); Nepal is yet to see such frequency in sending remittance, although the local economy is greatly sustained by the volume of international remittance inflow. As shown in Figure 21, 61% of the adult population send less often than monthly, and 73% receive less often than monthly. Around 16% send remittance once a year, while 8% receive remittance once a year. The fact that remittance receivers are mostly based in rural areas, where proximity to formal channels is a key barrier to access, provides an argument in favour of growing agent banking and/or electronic banking/mobile money (again, assuming that existing barriers can be addressed).

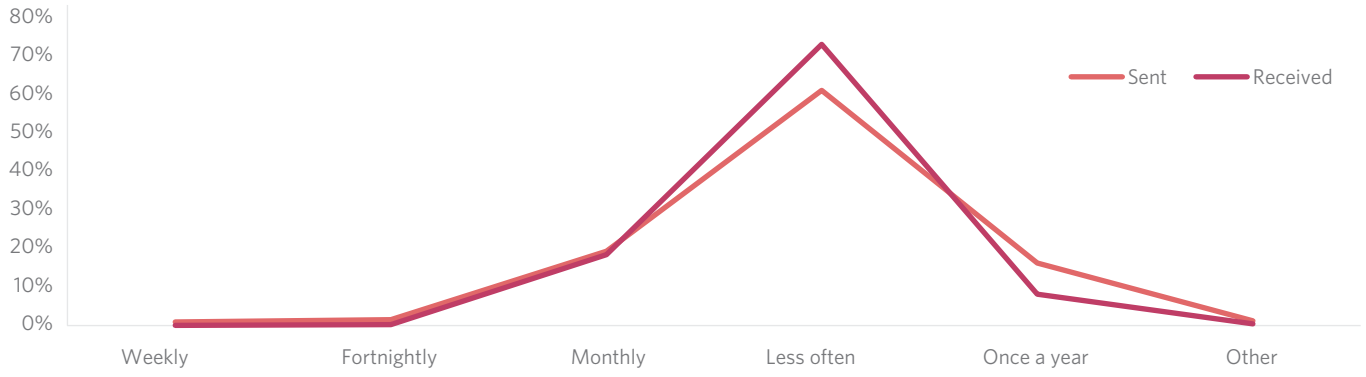


Figure 21: Frequency of remittance transaction in Nepal

Source: FinScope, 2014.

BOX 7. PAYMENT SYSTEM INFRASTRUCTURE IN NEPAL

This box explores the infrastructure that makes banking payment services possible in Nepal. The players in the payment ecosystem are as follows:

Stakeholder	Category	Ownership	Function
NRB – Payment and Settlement Department	Regulator	Government	Issues policies and guidelines to govern the BFIs and other formal payment service providers (currently remittance agents and switches).
Nepal Clearing House (NCH)	Clearing house	Public Limited (NRB, Nepal Bankers Association, and SCT)	Offers BFIs the facility to clear electronic cheques. In the future, NCH plans to establish a national payments gateway, which will facilitate electronic payments and financial transactions.
Nepal Central Depository and Clearing Ltd	Depository and clearing	NEPSE, CIT, Nepal Investment Bank, Bank of Kathmandu, Himalayan Bank, Kumari Bank, NIC Bank, Standard Chartered Bank, Laxmi Bank	Provides centralised depository, clearing and settlement services in Nepal.
SCT (Smart Choice Technologies) Network	Private card switches	Private SCT (local)	A national switch providing shared network services for ATMs and POS terminals. Currently operates over 1,149 ATMs and 2,000+ POS terminals and has 84 BFI membership.
NPN (Networking Professionals of Nepal)		Nepal Investment Bank Limited (NIBL)	A national switch providing shared network services for ATMs and POS terminals. Currently 35 BFIs are member of this switch.
NEPS (Nepal Electronic Payment Systems Ltd)		Seven national-level commercial banks: Citizen International Bank Ltd; Global IME Bank Ltd; Janta Bank Ltd; Machhapuchhre Bank Ltd; NIC Asia Bank Ltd; Siddartha Bank Ltd; Sunrise Bank Ltd	Card data-processing company established as a common platform for electronic payments. Besides supporting card transaction, NEPS plans to facilitate interbank transactions, e-commerce, remittance and branchless banking.
PayWay	Merchant payment gateway	Pay Way Nepal Ltd	A merchant payment gateway system allowing payments over the Internet. Permits online payment through credit cards and bank accounts.
M-Nepal	Third-party service provider		Third-party service provider assembling existing infrastructure to offer open and interoperable mobile payment, wallet and banking services.
eSewa	Wallet and payment gateway	F1 Soft	Digital payment portal providing online payment gateway and hosted wallet service with network of 21 BFIs. Operated on the platform of two major telecom operators: Ncell and Nepal Telecom.
FonePay	Mobile payment gateways	FocusOne (software company)	Facilitates interbank funds transfers, shared merchant payments with customer sharing, and utility bill payments. It has more than 65 BFIs as its members.
Hello Paisa		Finaccess	Shared-access mobile financial service platform and branchless banking service provider. Offers managed wallet product and account–account and account–wallet transfers. Operated on the platform of four telecom operators: Nepal Telecom, Ncell, SmartCell and UTL. Currently 7 BFIs are members of Hello Paisa.
SCT MoCo		SCT, FocusOne (software company)	Allows the usage of mobile phones for on-site and off-site financial transaction. Mobile phone can be linked to one or more SCT cards.

Source: Authors' own based on individual company's website and Report on Integrated Approach to Mobile Financial Solutions 2014 (Louis Berger).

What products are available and in use?

This section takes a closer look at the following payments products: account-based products, which include bank accounts, and mobile banking; and non-account-based products, which include domestic money transfers, and cross-border money transfers.

Account-based products

Bank accounts

Central bank proactively ensuring lower cost for saving accounts. In Nepal, savings accounts generally double up as transaction accounts for individual users. Generally, cheque books for savings accounts are provided free. The consumer can access card services, Internet banking and mobile banking services against the account opened. There are limitations levied on the total amount that can be withdrawn per transaction and on a daily and monthly basis via ATM, POS or Internet banking. This, however, varies greatly from one bank to another, with transaction limits of NPR 15,000–NPR 25,000 per transaction to NPR 200,000–NPR 500,000 per month. The limitation is set at the discretion of individual banks. Through Internet banking, funds transfer and utility payments are offered; but once again this varies from bank to bank. Although online fund transfer among a few networked banks is now possible, efforts are ongoing to make retail fund transfer possible among the existing banks.

BFIs are barred from charging service fees for opening savings/transaction accounts, closing accounts, providing branch banking services and issuing single bank statements. Moreover, BFIs are barred from charging fees for usage of valid electronic cards and reactivating inactive deposit accounts, and from deducting penalties for not maintaining a minimum balance (*The Kathmandu Post*, 2014). NRB, through the issuance of Provision on Consumer Protection and Financial Literacy, has attempted to be proactive and to increase the uptake of saving accounts. However, saving accounts provide an average of 1%–2% interest in banks, while the rate can go much higher in other formal channels such as cooperatives. The result is that the target market segments are more attracted to such channels for savings purpose. The inability of banks to recover the costs of maintaining saving deposits through fees has resulted in the costs being recovered in the margin; therefore, saving products have become uncompetitive, with the market offering mostly homogeneous products.

Usage of cheques increasing in urban areas. When cheque transactions started in Nepal, on average 6,000 cheques were transacted per day. Today, the number stands at 27,000–30,000 cheques per day. Despite the lack of proper payments system, the uptake of payment *technology* has been encouraging in Nepal. The central bank has made it mandatory for BFIs to issue machine-readable chequebooks with magnetic ink character recognition (MICR). However, Nepal Bankers' Association, which is a stakeholder in the country's only clearing house (Nepal Clearing House Ltd), has recently announced that cheques worth more than NPR 500 (US$ 5.07) will be charged with the maximum clearance charge of NPR 100 (US$ 1.01). Should a cheque bounce, NPR 100 (US$ 1.01) will be levied per cheque.

The fees levied on cheque transactions can discourage their usage among cost-sensitive target market segments. The MAP qualitative study (2015) has shown that cheques are largely used in Kathmandu Valley and other urban areas. Furthermore, the usage of cheques is primarily for encashment and not for deposits. The National Payment System Development Strategy (see Box 10) has emphasised the expansion of cheque truncation and clearing to the entire country. However, given the difficult geographical terrain, the usage and expansion of cheques as a payment tool may not be the most efficient tool of payment. It must be noted that globally cheque usage has declined.

Mobile banking

Mobile banking only used for deposit collection. Commercial banks of Nepal have led the proliferation of mobile banking in Nepal. This service is only used for deposit collection and payments and is yet to be used for loan disbursement. The lack of interbank fund transfer mechanisms hinder loan repayments via other e-banking mechanisms. NRB's directive on e-banking covers branchless banking, mobile banking, Internet banking and e-cards (Nepal Rastra Bank, 2068/69). The directive has defined the activities allowed under each e-banking subcomponent. The central bank has taken steps to increase knowledge in mobile banking and branchless banking because customer education is key in the adoption of technology. e-Banking directives make little distinction between mobile banking and mobile money, which include cards, mobile wallets and branchless banking systems.

Table 8 shows the uptake of mobile banking and branchless banking in Nepal. In the branchless banking scenario, the number of transactions is less than the total number of clients, which reflects the low usage of the service. Similarly, while client numbers are higher in mobile banking, the number of transactions per client remains low.

BFIs	Branchless banking clients	Mobile banking clients
Class A	151,066	768,424
Class B	0	63
Class C	0	13

Table 8: Uptake of mobile banking and branchless banking in Nepal

Source: Nepal Rastra Bank, 2014 (Financial Stability Report).

MFSPs operating in a closed-loop system. The usability of the service offered by MFSPs is limited due to their closed-loop systems and lack of interoperability. Urban branch customers are increasing using Internet banking services, which provide same-bank payments and other utility payments. MFSPs are mostly being used for airtime top-ups by urban and rural markets alike. Utility payments are being offered by MFSPs for some services but these are not real-time transactions; the current trend is to manually clear the bills paid, which can take from two to three days. The barrier here lies not only with MFSPs but also with the utility service providers, who are not providing access to digital records for bill payment and clearance.

BOX 8. SERVICES PROVIDED BY MOBILE FINANCIAL SERVICE PROVIDERS (MFSPS)

eSewa: *Launched in 2010, eSewa is a digital payment portal by FocusOne Solutions (technology/software company). Serving primarily as a mobile wallet, eSewa offers online and offline payment services to affiliated merchants as well as fund transfers to partner banks. In this respect, eSewa provides wallet–wallet transfers, wallet top-up from bank account and wallet–merchant and online payments. However, there are no provisions for mobile banking as such; for instance, account balance inquiry, and account–account bank transfer. Currently, eSewa has partnered with 35 class A and B banks. Moreover, with affiliation with close to 80 different merchants, eSewa provides services such as utility bill payments (which include electricity, telephone, water, education, Internet, and cable), top-ups, and travel and movie ticket payments. eSewa has also partnered with Western Union in directly transferring remittance received into eSewa members' accounts.*

Hello Paisa: *Started by Finaccess Private Ltd in 2012, Hello Paisa is a third-party interoperable mobile financial service platform. Hello Paisa provides five distinct services, including:*

- *Mobile account service: includes mobile account balance inquiry, transaction summary and other transaction-related services.*
- *Payment services: includes mobile top-ups, telephone, Internet, cable and movie payments.*
- *Money transfer services: includes wallet–wallet transfers as well as wallet–non-registered person transfers.*
- *Banking services: includes bank account balance inquiry, account–wallet transfers and vice versa, and account– account bank transfers.*
- *Merchant services: where payment occurs through Hello Paisa accounts from the user to the Hello Paisa merchants.*

Currently, Hello Paisa has partnered with seven different financial institutions, four telephone and mobile operators, and a cable and cinema service.

MNepal: *Similar to Hello Paisa, MNepal is a third-party MFSP with the objective of providing technical managed services and advisory services in terms of mobile money and mobile financial services. MNepal's range of services is very similar to Hello Paisa's:*

- *Mobile wallet account: customers get access to various transactions such as wallet–wallet transfer, wallet–bank account transfer, mobile top-up, bill payments and other mobile commerce payments.*
- *Mobile banking account: customers can link their mobile account to their bank accounts and conduct operations such as account–account transfer, balance inquiry, bill payments and merchant payments.*
- *Payment services: this can be provided through the wallet or the banking account. Services such as airtime top-up, domestic transfers, bill payments and government–person payments are available.*
- *Monitoring and supervision of agent network: agent networks are among the operations and thus MNepal monitors and supervises the agent networks. This essentially is targeted towards financial institutions, as an avenue for greater reach.*

MNepal is supported by IFC and is connected to institutions such as Himalayan Infrastructure Fund, Nepal Investment Bank and FocusOne Solutions software developers, and private switches such as Smart Choice Technologies (SCT) and Networking Professionals of Nepal (NPN).

SCT MoCo: *SCT MoCo offers mobile commerce solutions for SCT card holders, where the cardholders can access their bank accounts through their smart phones and make transactions either online or in stores. SCT MoCo has partnered with restaurants, clinics, travel agencies, online portals, telecoms, and TV cable operators (about 18 different establishments). Through this service, the customer can pay through SCT MoCo in person at affiliated stores, make online payments to connected online portals, and pay telecom and ADSL bills and perform top-ups. SCT MoCo is further supported by 67 out of 70 financial institutions of SCT.*

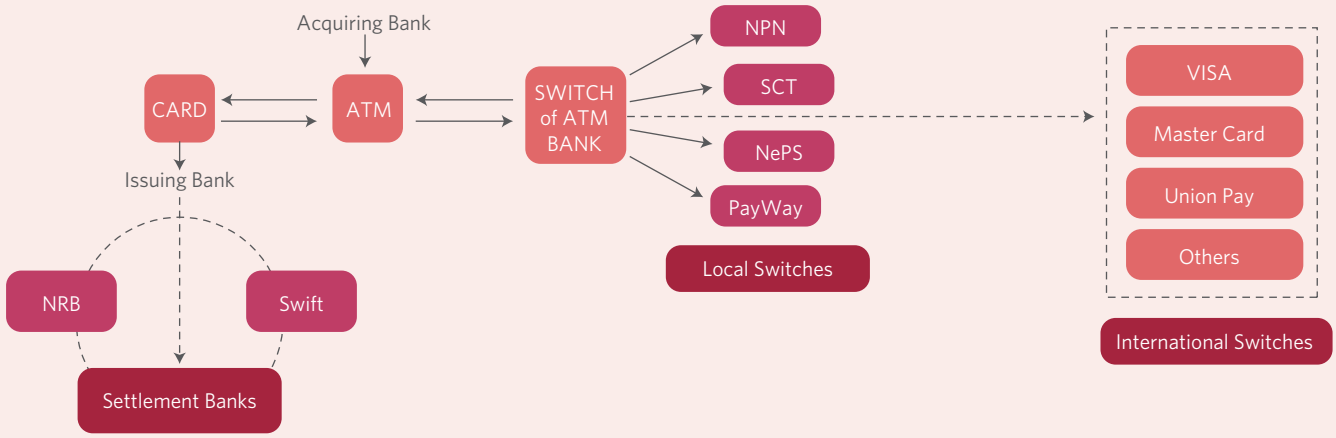


Figure 22: Card payment system in Nepal

BOX 9. MULTIPLE LOCAL SWITCHES DUPLICATING EFFORTS AND BYPASSING INTERNATIONAL SWITCHES

Local switches. *Nepal's payment market is dominated by the local switches SCT and NPN. There are also Nepal Electronic Payment Systems Ltd (NEPS) and PayWay switches.*

International switches. *While VISA and MasterCard are the two prime international switches, UnionPay is also increasing its market share in the country.*

Internal switches. *However, besides these networks, the larger commercial banks, such as Nabil Bank and Himalayan Bank, have their own internal switch, which is interoperable with other local and international switches and has member banks who use these switches.*

Market is overcrowded, with limited interoperability. *Given that the payment market of Nepal is in its infancy, with small market size and correspondingly small value of payment transactions, the existence of multiple switches with limited interoperability is bound to overcrowd the market – especially when BFIs are being amalgamated through mergers and acquisition and the number of BFIs can be anticipated to be greatly reduced in the future.*

Local switches are captive business. *The local switches are owned by consortia of BFIs, meaning that the switches are essentially getting captive business from the promoters. Furthermore, while SCT and NPN are issuing their own brand card, these switches along with other switches are co-branding with international brands of VISA and MasterCard.*

Multiple separate local internal routings. *In the absence of a national payment gateway, these local gateways are creating multiple, separate, local internal routings wherein non-association-branded cards can only be switched on limited local switches, but where local, international, card association-branded cards achieve a measure of interoperability.*

Currently the single-message transactions on association-branded cards are being switched and cleared locally; while the dual-message and EMV (Europay, MasterCard and VISA) POS are being switched via the MIP/VIP (Mapped IP/Virtual IP).

Insider fraud using credit cards – chip-based cards not yet widely available. *The banking industry of Nepal has faced a number of cases of insider fraud involving bank cards (see more at: http://myrepublica.com/portal/index.php?action=news_details&news_id=88266). Chip-based cards are still not being offered by all banks. The central bank has mandated the use of chip and PIN cards that will use the Static Data Authentication standard (Nepal Rastra Bank, 2014). Given the lack of payment regulations in Nepal, it presents both a vulnerability and an opportunity for the country in creating a robust payment regulation and network.*

Considerations of pricing and scale. *The local banks are issuing VISA, Mastercard and UnionPay cards switched via MIP/VIP, and so it is crucial to understand that, in order to be viable, these international networks are run at vast scale and that they are priced internationally to accommodate smaller players or banks that lack the upfront capital to develop their own switching and settlement capability. Although the individual transaction charges are high in these networks, this outweighs the high cost of capital investment for a small card base. Given that the number of card users is increasing, the effective capital cost per cardholder will come down; in time this will make it more viable to switch card association cards locally. Local switching always exists in addition to international switching if international card association-branded instruments are issued.*

Non-account-based products

Domestic money transfers

	Source	1995/96	2003/04	2010/11
Remittance transaction	Urban Nepal	NPR 4.1 billion	NPR 5.7 billion	NPR 25.7 billion
	Rural Nepal	NPR 6.1 billion	NPR 5.1 billion	NPR 25.2 billion
	India	NPR 4.3 billion	NPR 10.7 billion	NPR 29.2 billion
	Malaysia	NPR 2.9 billion	NPR 4.4 billion	NPR 25.2 billion
	Saudi Arabia and Qatar		NPR 12.2 billion	NPR 67.1 billion
	Other countries		NPR 7.9 billion	NPR 90.1 billion
Share of total remittance received	Within Nepal	44.7%	23.5%	19.6%
	From India	32.9%	23.2%	11.3%
	From other countries	22.4%	53.3%	69.1%

Table 9: Internal remittance trend by source in Nepal (in NPR billions)

Source: CBS, 2011 (Nepal Living Standard Survey).

Domestic remittance seeing increasing volume but overall decreasing share. Internal remittance in Nepal witnessed a sharp growth between the period of 2003/04 and 2010/11, as shown in Table 9. During this period, rural to urban migration increased as a result of political instability from the Maoist insurgency and the political turmoil that followed. The MAP qualitative study (2015) has shown that the lack of educational infrastructure in rural areas has also driven internal migration on the part of the youth population, who seek to further their education beyond secondary level. Although the volume of domestic remittance has increased, as a share of total remittance it has been greatly surpassed by international remittance from the growing numbers of people (mainly males) leaving Nepal to work as migrants in other countries (see Table 10).

Year	Total international labour migrants	Total international female labour migrants
2008/09	219,965	8,594
2009/10	294,094	10,056
2010/11	354,716	10,416
2011/12	384,665	22,958
2012/13	450,834	27,742
2013/14	521,878	29,152

Table 10: International labour migration trend in Nepal (2008/09–2013/14)
Source: Department of Foreign Employment, 2013/2014.

Easy process for sending and receiving remittance – other formal channels are preferred. In order to send remittance, the sender needs to present a valid government-issued ID card and fill out a standard remittance form mentioning the personal details of the sender and receiver. Thereafter, a unique code is provided, which the receiver needs to present along with a valid ID card in order to collect the payment. The MAP qualitative study (2015) has shown that remittance agents assist in the entire process of filling out the necessary forms, which means that people feel comfortable and not intimidated about accessing this service; this encourages the usage of these (other formal) channels.

Cross-border money transfers

International inward remittance expensive and processing can be slow. The Department of Foreign Employment data shows that Malaysia, Saudi Arabia and Qatar are the top three labour migrant destinations for Nepali adults. The regional average cost of sending remittance to South Asia is around 6.45% of the total cost. However, international *inward* remittance sending costs much more; Nepali migrants sending money from Saudi Arabia pay more than the regional average, with sending money from Qatar costing double the regional average. Processing time varies; while some transactions happen in less than an hour, other transactions can take up to five days to be processed (see Table 11).

Country	Firm	Total cost	Total cost %	Transfer speed
Malaysia	Bank	US$ 5.48	2.74	Same day
	Money transfer	US$ 4.94	2.47	
Saudi Arabia	Bank	US$ 8.09	4.05	1 hour–2 days
	Money transfer	US$ 7.75	3.88	
Qatar	Money transfer	US$ 14.49	7.24	1–5 days
United Arab Emirates	Bank	US$ 5.06	2.53	1 hour–5 days

Table 11: Cost of sending US$ 200 to Nepal
Source: World Bank, 2015.

Prepaid remittance card for inward remittance. International Money Express (IME) provides a prepaid remittance card service branded as IME Remit card, which provides banking services that combine the features of debit and remit. Customer can load the remittance amount sent through the IME agent network, both from abroad and within Nepal, into the card, after which the card can be used for cash withdrawals from ATMs, transactions at POS, and e-commerce transactions. This card is operable in VISA, SCT and NPN switches (IME Remit, 2014).

Who are the providers?

This sub-section considers the existing supply of payments services in Nepal in terms of players and products, including the payments infrastructure underlying each of the providers' operations.

Banks are the key providers of non-cash transaction services. BFIs are the primary providers of non-cash transaction products. Nepali commercial banks currently provide Internet banking, mobile banking, card services, ATMs and branchless banking as forms of electronic banking. Banks offer the facility to transfer cash into account, conduct electronic fund transfers (EFTs) and make card payments through POS devices. Mobile and Internet banking also act as avenues for customers to make payments, thereby reducing the need to use cash.

Banks are trusted, while cooperatives and MFIs are less so. Of the adult population, 54% trust banks, while only 1% do not trust banks. Although the FinScope survey showed that agent banking is the least trusted institution (with only 1% of adults trusting it), in fact the vast majority (i.e. 86%) of the adult population are not aware that agent banking exists. Despite the proliferation of cooperatives and MFIs, the level of trust in these institutions also remains low, with only 10% of the adult population trusting cooperatives.

Branchless banking agents can be leveraged, although the lack of mobile banking interoperability is a major challenge. The concept of agent banking has been widely accepted among formal financial service providers in Nepal, and networks of agents

are being used by banks to broaden their footprint. Previously, branchless banking agents were only authorised to use POS machines for their transactions, but now NRB recognises payments made through mobile phone technology. This can be leveraged as a cost-effective channel for increasing BFIs' distribution channels, because mobile money transactions make use of the established telecommunication infrastructures – and Nepal already has high mobile phone penetration. However, the lack of mobile banking *interoperability* poses a challenge for the bank agents. While third-party agents such as Hello Paisa are providing multi-bank mobile banking portals, these providers are operating in a closed-loop system, meaning that member banks of one provider cannot transact with member banks of another provider. This greatly reduces the convenience for consumers.

Urban-centric distribution network making formal payment channels – including agent networks – less accessible. There are 3,465 BFI branches across the country – that is, one branch for every 8,023 people. Similarly, there are 1,362 ATMs of commercial banks, which are the key providers of ATM infrastructure. However, these branches and ATMs are located in urban areas or the market centres of rural areas. The cost and time to travel to access these services makes formal channels less preferable and accessible, particularly for rural dwellers. Even in the case of agent banking, cash-out remains a challenge when proximity to formal banking infrastructure is limited; the agent needs to have enough cash to ensure fulfilment of transactions.

Restrictions on banks vs ease of usage of other formal channels is encouraging uptake of the latter. While current regulations restrict BFIs from making remittance payments of more than NPR 100,000 (US$ 1,015) in cash, and requires them to deposit amounts larger than this directly into the client's account, no such restriction is imposed on cooperatives. Given that the cooperatives are largely unsupervised, this ease of usage will tend to encourage uptake of financial services from these other formal channels.

Overlapping role of banks and MTOs/remittance service providers. Remittance service providers are regulated by NRB. Currently there are 50 money transfer operators (MTOs) licensed by NRB. However, commercial and development banks registered under NRB also provide domestic and cross-border transfers. Tensions have arisen on the part of providers due to the overlap in services and the discriminatory provision, which puts BFIs at a disadvantage. However, from a consumer point of view, the overlap is valuable as it tends to create healthy competition.

BFIs and remittance companies can make remittance payments up to NPR 100,000 (US$ 1,015) in cash, and anything exceeding that amount needs to be made through cheques or deposited into bank accounts.

The MAP qualitative research (2015) showed that very few of the people that use banks for remittance actually become bank clients in the sense of being bank account holders; and those that do generally tend to withdraw all incoming money in a single instance (i.e. using the account as a mailbox), and therefore do not use any other banking products.

Money transfer agents with their proliferation and human interaction are easily accessible and most popular remittance channel. The MAP qualitative research has shown that, for remittance payments, people prefer to transact with money transfer agents, as they are located in easily accessible places and people do not feel intimidated to use the services provided. This is also reflected in the FinScope (2014) data, which shows that:

- The formal channel (banks) is used by 24% (1.3 million) of remittance users, while the other formal channel is used by 56% (3 million) of remittance users.
- Money transfer agents are used by 53% of remittance senders.
- Money transfer agents are used by 63% of remittance receivers.

The qualitative study showed that people in rural areas in particular prefer the money transfer agents for sending and receiving remittance because such agents provide direct

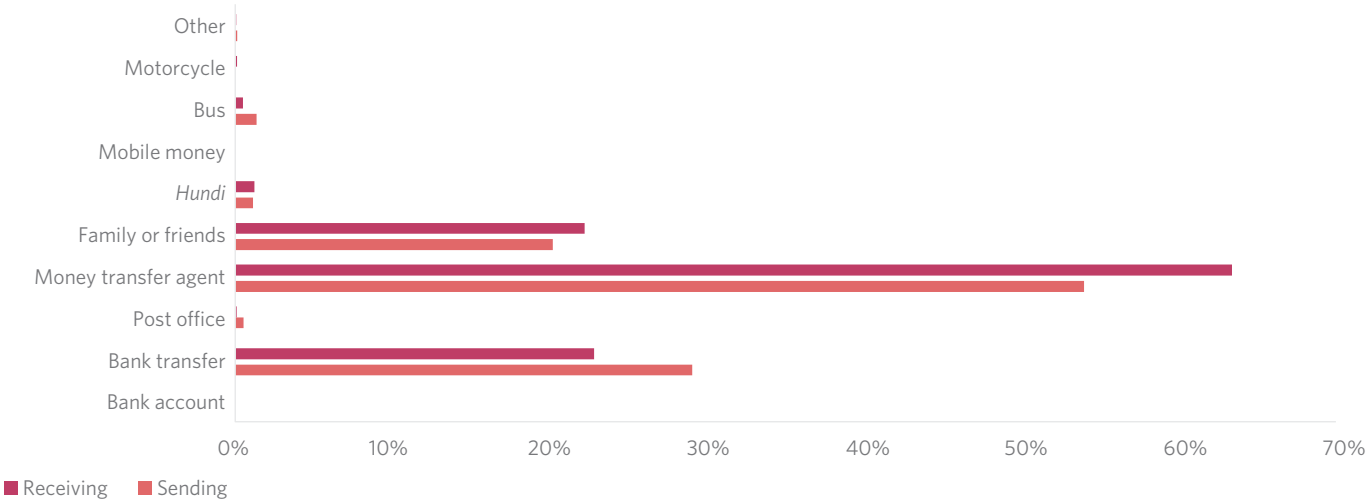


Figure 23: Usage of payment channels for sending and receiving money in Nepal

Source: FinScope, 2014.

assistance in terms of filling out forms and adhering to any other documentation requirements.

Figure 23 shows that the money transfer agent is the most widely used channel for receiving and sending money, followed by bank transfer, and family or friends.

Mobile financial service providers (MFSPs) hardly featuring as a payments channel. It is striking from Figure 23 that mobile money is even less used than motorcycles for sending and receiving money in Nepal – and in fact does not feature as a payment channel. MFSPs in Nepal are mostly run by private players and are built around isolated systems that are not interoperable. The proliferation of MFSPs combined with their lack of interoperability limits the usability of the payments service these providers offer, because customers cannot derive much value from isolated functionality.

Only a few post office outlets offering payment services. Nepal's post office provides postal financial services, including money order service, postal saving bank and remittance services. However:

- Of 520 post offices approved for providing money order services, only 79 are offering the service.
- Of 117 post offices approved for providing postal saving banking services, only 68 are providing such services.

Under the money order service, domestic remittance services and international remittance services to seven countries are provided. Furthermore, the post office has entered into partnership with Western Union Money Transfer and acts as the pay-out counter (Postal Services Department, 2015).

Despite its vast network and more than three decades of operation, the postal banking network has not been able to have any substantial impact on the financial sector or the payments sector. The lack of modern banking services on offer from the post office has resulted in people in urban and peri-urban areas shifting from postal savings. The number of postal saving banks has remained constant over a long period and the deposit base is growing at a very slow pace. A lack of skilled human resources trained in banking services has been a major hurdle in the expansion of postal saving banks.

Informal remittance sent through hundis *very limited.* Only 1% (116,000) of adults use *hundis* (informal MTOs providing cross-border transfer services) to send or receive remittance. The growth of informal channels is seen as a threat to the country's foreign exchange earnings, and thus NRB has imposed restrictions on Nepali and foreign nationals alike, forbidding the carrying of more than NPR 5,000 (US$ 50.75) cash when leaving or entering the country (*Republica*, 2015).

What are the barriers to usage of payments services and products?

Awareness and financial literacy are barriers to access. Customer education is a key challenge that needs to be tackled for the proliferation of payment services in Nepal. As shown in Figure 24, the majority of Nepali adults (57%) consider the requirement of maintaining a minimum balance a barrier to opening a bank account. However, for quite a long time, Nepali banks have offered a zero-balance account to all – and they continue to do so.

Another 47% of Nepali adults do not see the need for having a bank account. It can be assumed that the perceived benefits thereof are outweighed by the perceived negatives (including lack of proximity, for example). This also highlights the need for one-off services for transaction, similar to those provided by MTOs for remittance, where the customer does not need to maintain one or multiple bank accounts nor bear the cost or hassle of holding such accounts.

The MAP qualitative study (2015) has shown that even when people have some idea of banking products, the lack of clear knowledge and experience of use is resulting in lack of demand for existing relevant services being offered by BFIs.

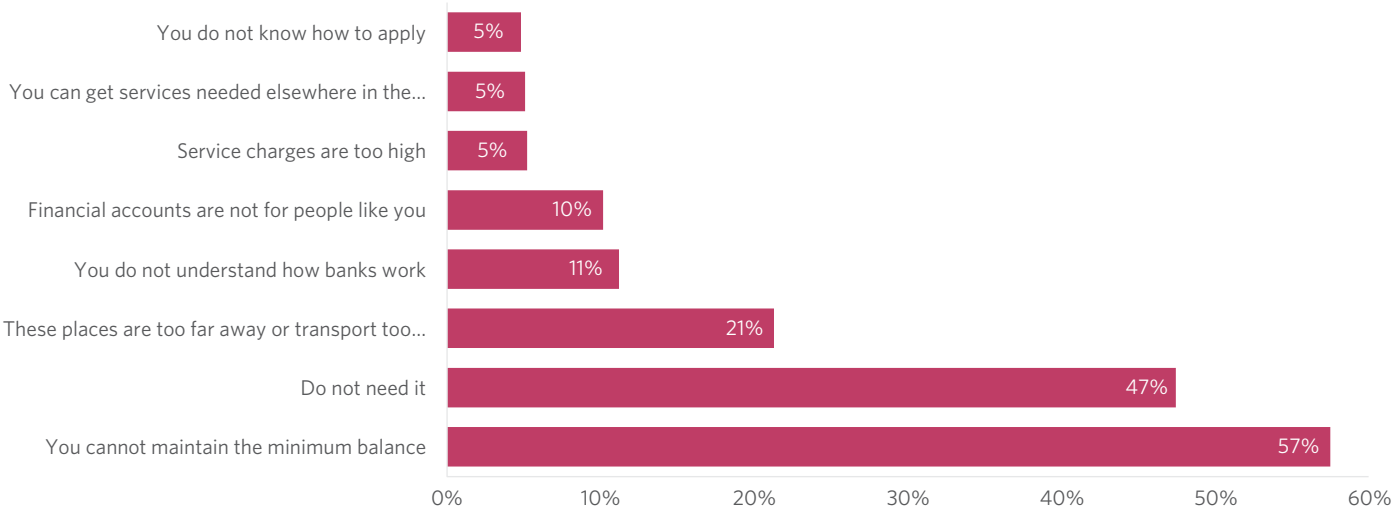


Figure 24: Reasons for not having a bank account

Source: FinScope, 2014.

"I get an SMS alert for deposit and withdrawal of cash from my account. They also have a mobile application with some services; I don't see the need of having the application. I can go to the branch to enquire my balance and I can also draw a rough estimate from the SMS alerts, which I don't delete." (Salaried worker, female, aged 38)

NRB prohibitions on banks charging services fees have become a major impediment. When establishing payment infrastructure, banks need to work within their cost structure; in order to increase inclusion, banks need to be sure that they can cover the cost of such services, to ensure that the investment makes good business sense. As already highlighted, the fact that banks are prohibited from charging fees for services such as opening accounts, closing accounts, providing branch banking services and so on, is making the business case for expanding such services unattractive. And while digitisation might offer some solutions, this is not straightforward. The NRB provisions have become a major impediment to the development of payment infrastructure.

Cost of digitisation high for bank. BFIs have very little incentive to expand digital transaction capabilities because this requires investment in hardware, software, human resources and telecommunications. Furthermore, there is the additional cost of educating people about digital products.

Branchless banking and ATM expansion not attractive business cases. Banks are also having a hard time breaking even from branchless banking. And, given that they may not levy charges for ATM transactions, the business case for establishing an ATM becomes unattractive.

Identifying viable business cases for banks and merchants. From the merchants' point of view, installing a POS machine and enabling card transactions would require merchants to pay 1% of the transaction value to the bank if own card or member bank card is used, and 2%–3% for other cards. Furthermore, the settlement takes one to two days, which disadvantages the merchant. POS machines at merchants are restricted to spot purchase transactions, and cannot transact a number of other transaction types (e.g. encashment, cardless payments and e-money transactions) that could potentially extend the viability of the merchant's business case for operating a POS machine. Larger merchants are in a better position because banks usually provide a 'package deal' covering credit, transaction and other banking services, wherein POS becomes a value-added service; this becomes a viable business case for banks and merchants alike, given the higher volume of transactions.

Low volumes of digital transactions have cost implication for providers. The fact that transaction volumes are low impacts on the service costs and pricing of digital transactions, which in turn tends to limit the customer segments that can afford the services. It therefore becomes a challenge to offer electronic/mobile banking services to broad enough audiences at scale so that sufficient turnover can be generated to finance the required infrastructure:

- During 2014, branchless banking clients for class A banks numbered only 151,066, with an average of only 0.73 transactions per client per year.
- Similarly, for mobile banking, the total client base of class A, B and C banks was 768,500, with an average of only 3.3 transactions per client per year.

This reflects the low adoption and usage of branchless and mobile banking services.

Lack of interoperability hindering creation of value for end users. The central bank has not explicitly laid out the requirement for payment channels to be interoperable. MFSPs in Nepal are working in their own, closed-loop systems, which means that customers of one payment service provider cannot use the same system to transact with another provider. Where there is no interoperability, there is a need for duplicated infrastructure: for instance, multiple ATMs next to one another. This increases the cost for the end user while reducing the effective footprint of financial infrastructure. Although ATMs accept a wide range of cards, the charges levied on non-member cards discourage use of the available infrastructure. When considering interoperable systems, the strategic and cost implications of such functionality need to be considered in terms of a sustainable business case for BFIs, in order to encourage them to participate in such a system.

Culture of avoiding formal channel of transaction. Promoting the digitisation of money will result in transactions coming into formal channels and this is likely to be met with resistance. The widespread culture of avoiding tax makes businesses wary of adopting digital payment channels. For instance, grocery shops and small garment shops pay the minimum of tax: NPR 3,500 (US$ 35). The rest of the money remains unaccountable. The usage of a POS or a swiping card records the transaction and

BFIs	Mobile banking			ATM outlet	Debit card	Credit card
	No. of clients	No. of transactions	Transaction (in NPR millions)			
Class A	768,424	2,521,007	18,201,767	1,362	3,641,960	57,898
Class B	63	54	2,044	260	465,640	0
Class C	13	8	1	30	23,642	0

Table 12: Uptake of payment channels in Nepal and volume of transactions – mobile banking, and cards

Source: Nepal Rastra Bank, 2014 (Financial Stability Report).

registers the income in the formal system, making it taxable. By the same token, the proliferation of retail digital payment services has the potential to reveal the extent of the tax base for more equitable recovery of the tax burden. A culture of tax avoidance represents a formidable barrier to the adoption of digital commerce.

Digital payment plagued by infrastructural and operational issues. Developing and expanding electronic banking/mobile money requires a reliable, high-integrity digital backbone. However, the mobile communication network currently available in the country is unstable: making/receiving calls is difficult, there are delays and failure in sending text messages, and Internet connection is unreliable.

Lack of trust. In order to develop the value proposition for electronic banking/digital money, it has to be: reliable, widely accepted, readily accessible, and easily substituted for cash. The absence of different layers of retail payment systems and the lack of reliability of service have served as obstacles to the adoption of and development of trust in the digital payment system.

Delays in settlement of transactions. Furthermore, Nepal does not have an RTGS system; thus settlement of the transaction becomes a 'hassle' factor for BFIs and merchants alike.

Significant security concerns. In terms of security, the central bank mandates that more than one factor authentication should be used for activities like fund transfers through Internet banking facility. For card transactions, although NRB has mandated chip cards (which would use the Static Data Authentication standard), banks are awaiting NRB directives on the standards to be adopted (Nepal Rastra Bank, 2014). It is unclear to what extent offline chip-based authentication and clearing will be permitted for issuers, although the reliability of financial and network infrastructure would point to the necessity of a mitigated offline chip-based authentication capacity.

What regulatory and policy issues need to be considered?

A number of regulations and policy decisions need to be taken into account. Many of them could be classified as barriers.

Regulations severely limit provision of transaction services. Banks are equipped with systems that allow for digital payments and money transfer for people *without an account* and with only a phone number – but banks are unable to deploy this technology because the regulations do not allow this. Given that the mobile operator already has the record of the user from issuing the mobile number, a relaxation on this restriction would facilitate the expansion of transaction banking services. Currently, MFSPs do not come under the purview of the central bank and are not mandated to have a bank account linked to the mobile money accounts. This raises the issue of consumer protection risk when the MFSP fails. The MFSPs use formal banks for the funds in transit, where the money is in a trust account while the transaction is executed.

MFSPs such as Hello Paisa currently provide mobile money accounts that are not linked to an individual bank account, which allows the customer to pay bills, and to deposit and withdraw cash from their mobile account. Cash-out is done through a cardless cash system from member bank ATMs. In this system, the user needs to request a six-digit one-time password (OTP) for the amount to be withdrawn. This is then verified through the individual PIN, and withdrawal is made. (Clearly there must be a limit to the value of transactions or balances permitted on such platforms so as to align with AML/CFT risks.) Payments and encashment through POS/POT machines make the usage of payment channels cheaper for the stakeholders, while growing the volumes of transactions, which in turn starts to present a more attractive business case.

Need to introduce telecom regulation to establish a reliable base for MFSPs. The telecom operators are governed by Nepal Telecommunications Authority (NTA). In mobile banking, the technical risk of collaboration between telecommunication and banking services needs to be evaluated. In cases of transaction discrepancy and other issues, it needs to be clear where the operators and banks need to go for settlement. This requires the establishment of regulations to govern the telecom operators so that BFIs, telecom operators and third-party providers can work on common ground. The telecom operators also need a standard approach and process from BFIs. In the absence of clear legislation delineating the spheres of authority, the NTA and NRB can in the interim introduce a joint policy and MoU, outlining a clear split on areas of authority with regard to overlapping regulation and supervision.

Provision not clear on collaboration of banks with MFIs. The banking regulation does not allow commercial banks to collaborate with MFIs. However, there is a provision that allows commercial banks to seek permission from NRB to operate with MFIs. Once such a proposal has been received, NRB will give a decision with consideration to client protection and risk protection (ADB, 2012). Commercial banks have the technology that can be leveraged through the network of MFIs. If commercial banks can easily collaborate with MFIs (which focus mainly on loan disbursement), banks can provide access to saving, payments and other banking services to a larger segment of the population. Furthermore, banks can explore the option of prepaid debit cards or ISO debit cards as a loan disbursement and repayment mechanism in remote areas where individuals have access to ATMs or a banking agent.

Payment system still under development, needs timely, forward-looking regulation. Nepal's payment system is very underdeveloped; as mentioned, the central bank only recently established a Payment and Settlement Department to oversee the payments market. Payments is a very technical field and will require specific skill sets to evaluate, monitor and regulate the market. The country needs payment regulations that are forward looking and, rather than focusing only on the immediate requirements, take high-tech tools (e.g. distributed ledger technology) into account. Not only will this help to provide policy stability, but it can offer a better fit between technology

BOX 10. NRB'S NATIONAL PAYMENT SYSTEM (NPS) DEVELOPMENT STRATEGY – THE NINE PILLARS

Pillar I – Legal framework. *Payment systems in Nepal work in a sound and robust legal environment. Ensure that the NPS is fully supported by a well-articulated legal framework to address both legal obstacles and regulatory stances.*

Pillar II – Settlement mechanism *for large-value and time-critical payments in Nepal are safe and efficient and comply fully with the* Principles for Financial Market Infrastructures *(published by the Bank for International Settlements, or BIS, and International Organisation of Securities Commissions, or IOSCO, in April 2012 and replacing the previous* Core Principles for Systematically Important Payment Systems*).*

- *Systematically Important Payment Systems (SPIS) is a crucial part of NPS and will serve major interbank financial markets in the country.*
- *Currently all automated interbank settlement is made by SWIFT to the Clearing Division in the Banking Office at NRB.*
- *High-value customer payments are made by cheque with special daily manual clearing of any cheque more than NPR 100 million.*
- *Intends to acquire and implement a Real Time Gross Settlement (RTGS) system to enable straight-through-processing (STP) of interbank fund transfer in real time.*

Pillar III – Retail payment systems *in Nepal are efficient, sound and interoperable and support a wide range of payment instrument and services.*

- *Nepal Clearing House (NCH) to expand the current service of cheque truncation and clearing to the entire country and not limited to Kathmandu.*
- *Establish automated link between NCH and RTGS system.*
- *Expand NCH's interbank clearing operations to include both direct credits and direct debits.*
- *Connect Smart Choice Technologies (SCT), the largest interbank card-based switching and clearing service provider, with RTGS system thereby eliminating current system of clearing from commercial banks.*

Pillar IV – Government transactions. *Government collection and disbursement are fully and efficiently integrated with the NPS in Nepal.*

- *Plan to replace government bank accounts through the establishment of a Treasury Single Account (TSA) at NRB.*
- *Develop a scheme with Ministry of Federal Affairs and Local Government to make welfare payments via electronic transfers.*
- *Plans to implement electronic payment orders for tax payments and customs payment.*

Pillar V – Securities depository, clearing and settlement. *Securities depository, clearing and settlement are safe and efficient, fully comply with international standards and support the development of capital markets.*

- *Establish Central Securities Depository (CSD) system to facilitate government's domestic debt operations.*
- *Establish an integrated auction system for primary market operations with a trading platform for secondary market trading.*

Pillar VI – Money market. *Interbank money markets are fully developed and closely integrated with settlement systems.*

- *Establish modern interbank money market with settlement of transactions in the RTGS system and support NRB's monetary policy operations.*

Pillar VII – International remittance. *International remittance and other cross-border payments are distributed rapidly and conveniently in Nepal and are cost efficient from the perspective of end users.*

- *Undertake stock-taking exercise vis-à-vis the CPSS/World Bank General Principles for International Remittance Services and identify specific actions to be taken with regard to the existing and planned payment systems.*

Pillar VIII – Oversight. *The oversight and supervisory framework for payments and securities settlement systems is clearly defined and NRB exercises its oversight authority effectively in cooperation with other regulators and supervisors.*

- *Establish an oversight unit, which will ensure that an adequate degree of participant cooperation exists; verify that individual payment systems satisfy user needs along with risk and efficiency requirements; define and implement appropriate actions; collect and distribute relevant statistical information.*
- *Develop and automate NRB's data reporting platforms and data storage systems.*

Pillar IX – Cooperation. *Effective, structured and fruitful cooperation is in place with the NPS.*

- *Effective cooperation between stakeholders to facilitate the payment ecosystem.*
- *Establish National Payments Council, which will be the permanent body for a high-level cooperation between all stakeholders.*

and the geographical environment and existing infrastructure. The regulations should aim for the harmonisation of the terms and reciprocity of payment instruments. The regulations need to be structured to allow semi-autonomy to full autonomy to the regulators, thereby allowing regulators to be facilitative and react in a timely manner to current developments. Furthermore, increased autonomy would ensure that the regulators were not hamstrung by the overlaps between government ministries.

Regulation should establish clear grounds to foster healthy collaboration and competition. The payment regulation furthermore should establish a clear competition space and also a space where banks collaborate. Under this, in the collaborative space, BFIs can share the same payment infrastructure. For instance, the POS machines currently being used in Nepal can only host one bank network. Thus each bank issues its own POS, resulting in duplication of infrastructure at a single large merchant and absence of infrastructure for smaller merchant. Moreover, given the size of the Nepali market and the presence of a large number of BFIs, the country needs cooperation to achieve scale through joint effort. While promoting cooperation among the BFIs, the regulator should consider consumer protection, in that banks should be prevented from forming an oligopoly, which would disadvantage end users.

Central bank's proposed National Payment System. NRB has proposed a strategic plan to develop the country's National Payment System (NPS), in an attempt to cover all the required elements of an NPS. In the document National Payments System Development Strategy issued in 2014, NRB outlines nine pillars, in the process attempting to cover all the elements of the payment system. The section of this report on the gaps and opportunities with regard to payments provides an analysis of this NPS strategy.

What and where are the gaps and opportunities in the payments market?

Use cases per category of payment

This section outlines some of the main use cases for potential uptake of cost-efficient and cost-effective payments mechanisms in Nepal.

Salary payments (G2P, D2P, B2P, P2P). As already discussed, the majority of salaries are paid in cash (including a surprisingly high 67% of salaried workers). The government has become a champion of electronic transaction by promoting the usage of bank transfer and cheques (which are then cashed) for salary payments. Employment and the resultant payment of salary into accounts can be a stepping stone to opening an account. About a third of adults receiving wages in developing economies report having their first bank account, which was opened specifically for the purpose of receiving their salary (WB Group, 2014).

Remittance (P2P). The large number of adults receiving international remittance has already been discussed, as has the preference for relying on money transfer agents for remittance payment and receipt. Ease of access and usage is one of the drivers for the high usage of other formal channels. Currently, 24% of the remittance receiving population is using formal banking channels, while 19% still remit through friends and family; since the regulator has issued a directive limiting individuals to carrying local currency of NPR 5,000 (US$ 50.75) when leaving or entering the country, however, this provides an opportunity to bring the informal users into the formal channel.

Bill payments (P2G, B2B, P2B). The transaction cost of bill payments will be a crucial factor in determining the preferred channel of payment for each target market segment. Generally, the consumer does not pay for an electronic bill payment, because in a sustainable electronic payments model the cost of an electronic transaction is lower than the administrative cost and consumer inconvenience associated with cash payments at a designated administrative office.

Spot payments (P2B). Until electronic channels are more trusted, consumers will continue to prefer cash transactions for spot payments.

Social benefit and welfare transfers (G2P, D2P). Disbursement to the Ministry of Federal Affairs and Local Government's approximately one million social protection beneficiaries has up to now been mainly in cash. However, a pilot project has been launched by the Ministry to make payments by means of electronic transfers, leveraging commercial banks' existing networks, and this could act as an important motive for recipients to open and access bank accounts.

Tax payments (B2G, P2G). While the IRD's online revenue accounting system, enabling taxpayers to submit tax returns electronically, is a step in the right direction, as we have already noted online tax payment is not yet an option. A robust and efficient tax collection system is vital for fiscal stability, and an improved tax collection mechanism would enable the expansion of the tax net to the currently excluded sections of the population. The adoption of an electronic tax payment system can increase the effectiveness of small-value payment collection, leading to increased compliance on the part of those who owe tax, and reducing collection costs. Importantly, an electronic tax payment system can also act as the entry point for consumers and MSMEs to interact with formal payment channels more consistently.

Procurement (G2B, D2B). The process of and controls over procuring goods and services for which tenders are taken out has already been discussed. The Ministry of Finance is in the process of implementing a Treasury Single Account at the central bank, with the objective of replacing the thousands of existing government bank accounts throughout the country, including accounts at the central bank and commercial banks (Nepal Rastra Bank, 2014). This will go a long way towards making the government procurement system more efficient.

Analysis of NRB's National Payment System Development Strategy

This section analyses NRB's National Payment System Development Strategy, highlighting priority areas and opportunities.

The development of the National Payment System (NPS) should be prioritised. People in Nepal have yet to understand the benefits of an effective payment system. The country has coped to a degree without crucial payment systems like RTGS; the current system is functional but slow, and can take two to three days to clear payments. With the increase in transaction volumes, slow systems can be a major hindrance to efficient functioning and financial access. The proposal is to route the RTGS through Nepal Clearing House so as to ensure a faster settlement process.

The development of the NPS should be made a priority by the central bank to foster steady and stable growth.

Prioritise RTGS. The nine pillars identified in the NPS Development Strategy can result in the establishment of a robust payment system in the country. In the current scenario, the top payment infrastructure priority should be the establishment of the RTGS system, which will enable straight-through processing of intra-bank fund transfers in real time. Nepal needs direct investment, resources and governance in payment systems such as RTGS, retail EFT and card instruments, which can better serve individuals living in rural areas where proximity to formal channels is a key barrier to access.

Prioritise security management. Furthermore, security management should be a key priority because security is the backbone of a robust digital payment system.

Prioritise interoperable card and retail fund transfers over cheques. The NPS Development Strategy emphasises the expansion of cheque truncation and clearing to the entire country from the current service, which is limited to Kathmandu Valley. It should be noted that cheques are globally considered to be an inefficient payment instrument, with usage and perceived usefulness arising from lack of alternative effective payment channels and instruments. This implies that priority should be given to the establishment of interoperable card and retail fund transfers.

Expand interbank clearing. The establishment of Nepal Clearing House (NCH) has facilitated transaction banking in the country. The interbank payment system provided by the clearing house facilitates non-paper and non-card-based electronic transactions. Furthermore, it will support direct credit payment and direct debit collection between the member banks. The expansion of Nepal Clearing House's interbank clearing operations to include both direct debit and credit will be a vital provision for the expansion of mortgages, asset financing and insurance markets and also the capital market. The expansion of securities depository clearing and settlement should be linked to the RTGS system so as to manage same-day exposure.

Although NCH has 125 member BFIs, only 10 banks have so far subscribed to the interbank payment system facility, which is not currently operational. If implemented on an interoperable, open-system basis, this type of system would represent a significant step towards supporting the reach and sustainability of financial services offerings, particularly to market segments with limited access to the financial services that they require. NCH plans to bring in more members before making the interbank payment system operational. With greater number of members, the interoperability will greatly facilitate transaction banking in the country.

Beware overregulation of the market. Furthermore, while adopting international best practices, it is crucial to ensure that the market is not being overregulated to the extent that growth of the sector is constrained.

Government collection and disbursement will strengthen digital financial systems. The NPS strategy also emphasises the integration of government collection and disbursement into the national payment strategy. This will greatly influence the uptake of formal channels and will also aid in ensuring the sustainability of consumer- and retail-level digital financial services.

Consumer interests in payments system must be represented. In terms of the establishment of the National Payments Council, it is crucial that consumers be represented in the council, without which there would be a risk of creating an industry body with self-interest strategies. This could constrain development, especially in areas where the players have made previous sunk-cost investment decisions or in scenarios where disruptive technologies can upend business models.

Other areas of opportunity

Focus on collaboration to cut infrastructure costs. Through collaboration, BFIs can bring down the cost of payment infrastructure. This is thus a key area in which providers in the Nepali context should be pushing for ongoing improvements to the regulations, in terms of: which providers are permitted to collaborate; telecommunications/banking authority overlapping areas of authority; and provider interoperability.

A POS machine costs around NPR 20,000–NPR 30,000 (US$ 202–304). The costs for banks become substantial when they have to issue thousands of POS machines. Instead, a single POS should be able to host multiple bank networks, bringing down the overall cost through sharing with network banks. Moreover, banks have started to outsource POS device placement and maintenance to third-party operators. This provides a good business case for banks and third-party operators alike to maintain POS devices that can handle multiple bank network platform, which makes is cost efficient for all parties involved. The same applies for infrastructure such as ATMs.

Leverage donor funding to raise awareness of digital transaction and adoption of innovative business model. Currently, scattered efforts to raise financial and digital awareness by multiple donors has created duplication in some areas and exclusion of other areas, and the anticipated impact has not been created. The central bank is already focusing on financial literacy, consumer protection and financial inclusion. The government, through the *creation of access mapping of the country*, should consolidate the work of agencies working in the field of access to finance. Thereafter, donor efforts could be directed at particular areas and particular subject matter so as to attain the goal of increased financial literacy.

Furthermore, development partners are already collaborating with multiple BFIs for the expansion of branchless and mobile banking. Efforts should be made to experiment with various business models and innovative practices to identify models that best fit the Nepali market scenario, and these could then be benchmarked and replicated by other BFIs in the country at lower risk.

Focus on strengthening agent networks. Although BFIs are leveraging agent banking in Nepal, there is no requirement that agents be exclusively affiliated to one bank. In addition, agents are often inactive, with many only being active on payday. It is vital that there are reasonable numbers of agents in a particular area to ensure the functioning of the branchless banking and mobile banking ecosystem. The geographical challenges of Nepal can be tackled to a greater extent through the leveraging of digital banking services, and agents are a crucial part of such expansion. The existing agent network should be enhanced through the establishment of standard qualification criteria and operational guidelines.

Ensure that the benefits and security of carrying a card outweigh benefits of carrying cash. If a customer needs to travel for two hours to pay their electricity bill worth NPR 500 in cash, then they would derive greater benefit from a digital payment service through which they can settle the utility bill via mobile or Internet banking, rather than forgoing half a day's pay or equivalent production just for the sake of paying a bill during office hours. However, only when the benefits of digital transactions (e.g. easily accessible, reliable, affordable) outweigh the costs of carrying cash (e.g. inefficiency, security risk, travelling to make payment etc.) will the shift to a cashless system be possible. The growth of digital payment mechanisms is dependent, however, on a more reliable digital communications backbone in place, as well as improved banking infrastructure (encashment) providing improved cash reticulation networks.

Interoperability will aid in the adoption of digital instruments. The NPS Development Strategy proposes the establishment of an efficient, sound and interoperable retail payment system that will support a wide range of payment instruments and services. Currently Nepal does not have an automated, interbank payment system. However, private enterprises are providing interbank card-based switching and clearing services, and the adoption of card services has been increasing gradually.

Multiple barriers to be dismantled in order to achieve interoperability. Despite the interoperability of cards, the fee levied for this interoperability acts as a disincentive to making interoperable transactions. The interoperability of banking services and mobile financial services should be facilitated by ensuring that transactions are low cost; without this, customers will be hesitant to adopt. On the flip side, without substantial volume of transactions, it would be unfeasible for banks to provide the service at low cost, and it becomes difficult to operate so many switching and clearing facilities at scale in Nepal. This implies that institutional transactions need to be routed through digital channels to provide volume as well as to introduce users to digital payment channels.

Grants, social benefits and welfare transfers through non-cash channels can encourage use of digital channels. Given that the government is the largest user of this payment channel, the disbursement of grants, benefits and welfare through digital channels such as mobile money can bring down the cost of distribution. Such transfers can also be a practical experience for non-users to adopt digital channels.

Note: The crucial caveat to expansion of electronic banking and to broader digitisation is that the encashment or acceptance infrastructure needs to be in place prior to roll-out in each district, to avoid the potential for hardship due to the inability to use funds in digital form. In addition, existing weaknesses in the telecommunications system/network need to be addressed.

The market for savings

Summary

- A significant proportion of adults in Nepal save.
- People with low incomes want to save and are capable of saving.
- The main uses of savings are consumption smoothing, education, risk mitigation, and providing for old age and retirement.
- Investment, and providing for a future special event are further important reasons why Nepalis save.
- The main institutional providers of savings are banking and financial institutions registered with the central bank (i.e. commercial banks, development banks, finance companies and MFIs).
- Of formal providers: commercial banks and development banks are the dominant providers of formal savings in terms of deposit values; SACCOs are the dominant providers in terms of client numbers.
- Overall, in terms of client numbers, informal savings groups are the dominant providers of savings in Nepal.
- The informal savings groups have seen significant growth.
- There is significant overlap between use of formal and informal saving mechanisms.
- Banks are cited as being the most trusted providers, despite the significant uptake of savings from SACCOs and informal savings groups.
- Saving at home (monetary and non-monetary) is still a key 'provider' of savings, although increasingly less so with the growth of SACCOs and informal savings groups.
- Males tend to have higher access to formal savings services and products. Females have higher access to informal savings and saving-at-home options.
- Low-value, irregular-deposit, short-term saving products that offer real returns are in high demand among the rural population.
- The lower income groups are catered for by SACCOs, MFIs and informal savings groups.
- Across the formal providers, the product offering is relatively homogeneous.
- Savings accounts with banks offer low – sometimes negative – returns. SACCOs are the only savings providers currently delivering real returns.
- SACCOs and savings groups offer their members additional benefits, such as substantial loans and credit.
- Proximity is cited as a barrier to access to saving mechanisms in rural areas.

Context

High value of savings held. Gross savings accounted for 43% of Nepal's GDP in 2013 – a value that has grown steadily in recent years. This is a high value for a savings pool in its own right, as well as compared to regional neighbours in the South Asian Association for Regional Cooperation (SAARC).

To illustrate, in 2013, gross savings as a percentage of GDP sat at the following values for the region: India 32%, Pakistan 21%, Bhutan 26%, Afghanistan -21%, Sri Lanka 26%, and Bangladesh 39% (CBS, 2014). Note that the total value of savings being cited here only includes measurable monetary savings held in the *formal* sector and would comprise savings from both retail and corporate sources – in other words, were savings that are done informally to be taken into account, the figures would be different (and, given the cash-dominant nature of Nepali society, much higher).

Savings the most popular financial service across the board. The most commonly used and most popular financial services/products across all the target market segments in Nepal are savings services and products.

The majority of the adult population (59%) use financial services primarily for the purposes of saving.

As we see in this section on the market for savings, *all* of the target market segments in Nepal, no matter how small their levels of income and thus levels of saving, report some level of savings uptake – indicating a *significant savings culture* across Nepali society. The FinScope (2014) Nepal data shows that people with low incomes want to save and are capable of saving.

What saving is done, and how?

Significant numbers of adults save. In Nepal, 57% of the adult population have access to some kind of savings mechanism (including saving cash at home) (see Figure 25). This means that across a range of providers, including non-monetary savings (in the form of assets such as housing, jewellery etc.), two-thirds of the adult population in Nepal are saving.

Formal institutions are popular for savings purposes. When the figures are broken down by provider grouping, it emerges that 40% of adults save in formal institutions, 16% save through informal mechanisms (e.g. savings groups), a low 1% save at home or with household members, and 43% use no savings mechanism at all.

Savings access is driven by both formal and informal providers. As shown in Figure 26, when overlaps between providers are taken into account, it is clear that both banks and other formal players are important providers for formal savings access. The level of

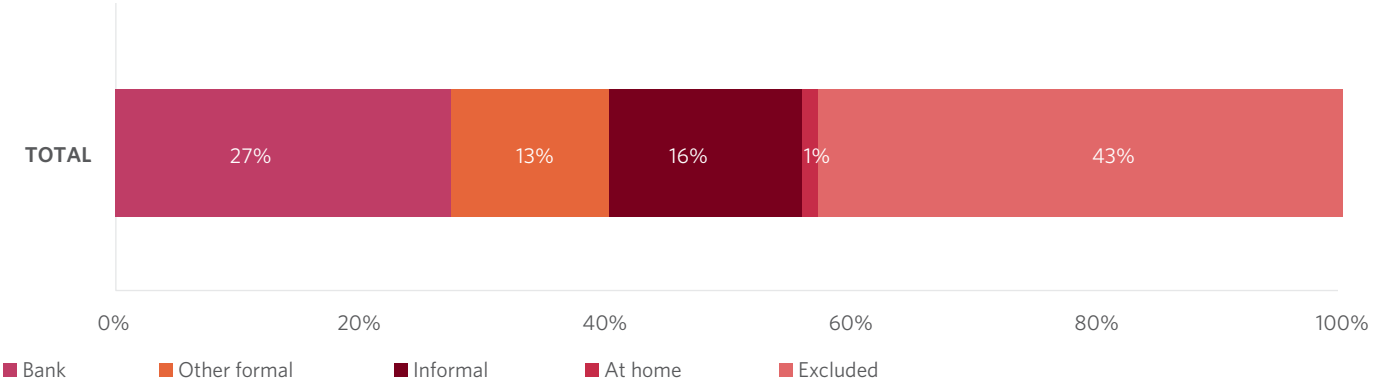


Figure 25: Savings access strand
Source: FinScope, 2014.

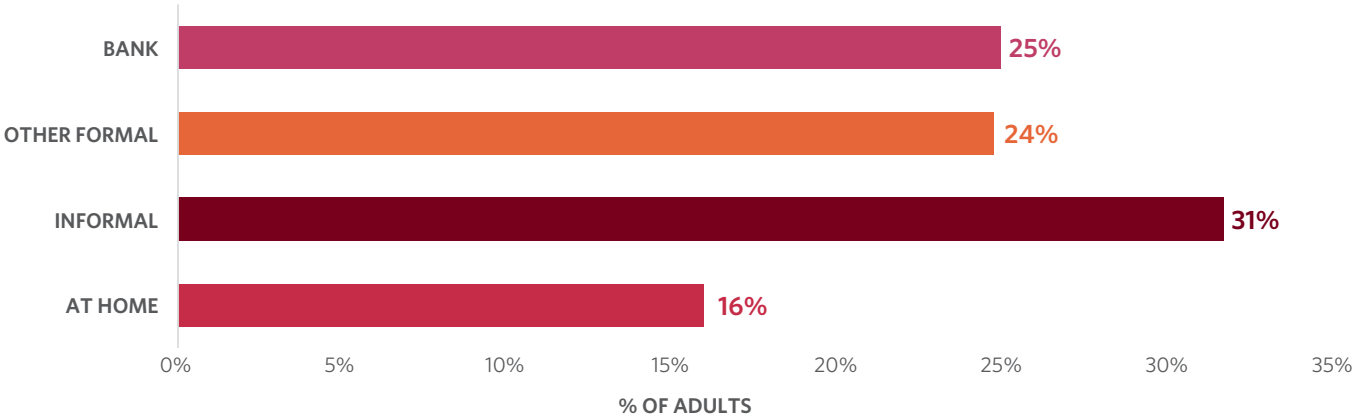


Figure 26: Savings access (including overlaps)
Source: FinScope, 2014.

access they provide is on a par, with 25% and 24% of adults taking up savings through these providers, respectively.

When overlaps are considered, saving through informal providers is the most popular. Of the Nepali adult population, 31% are taking up savings through informal providers.

Significant overlap between formal and informal saving. The difference between general access and access including overlaps indicates that there is an overlap in usage between savings providers (i.e. savings products are being accessed from more than one category of provider).

In particular, there is significant overlap between formal and informal saving, with 9% of the adult population saving in both formal and informal channels (when examining the overlaps between bank and other formal with informal – see Figure 27). It is worth noting that there is the same level of strong overlap between the two formal providers too (i.e. banks and other formal providers). Note that the analysis in Figure 27 only reviews institutional players, and does not consider saving-at-home behaviour; therefore, the red block includes one other, silent provider.)

No saving. Of the adult population, 43% reported no saving. One of the main reasons identified by the FinScope (2014) survey for low or no savings is that people have little to no money after meeting living expenses; of adults that do not save, 59% noted this as the reason why. A further 39% of this group indicated no income or no money to save in the first place. This is understandable in a population with very low income levels, where sourcing any level of surplus is difficult – although not impossible; there is evidence across the MAP studies to date of populations that sit below international poverty lines, yet manage to save small values towards prioritised needs.

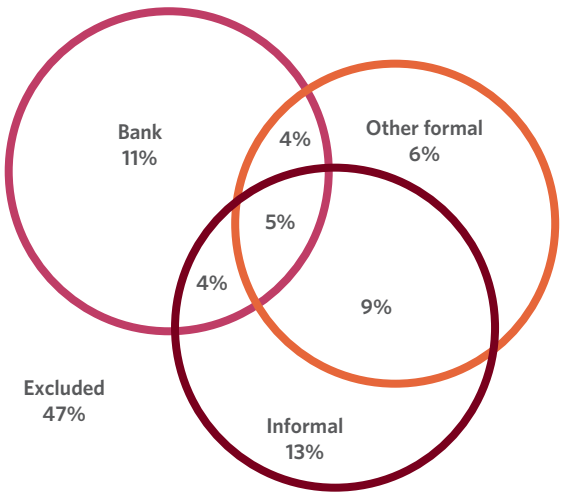


Figure 27: Savings access including overlaps (but excluding saving at home)
Source: FinScope, 2014.

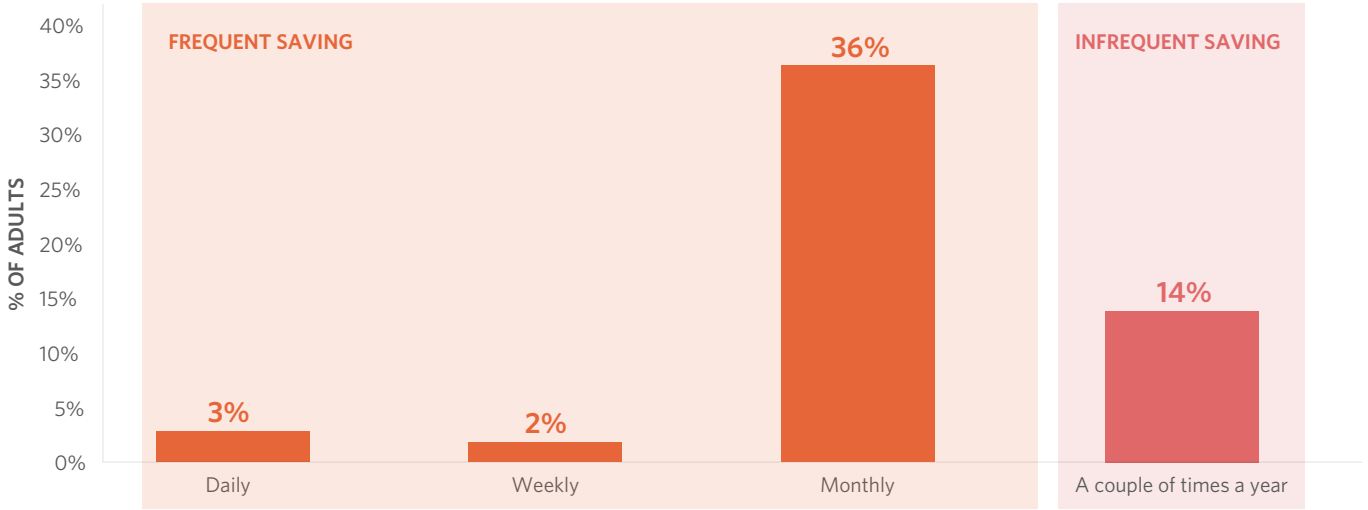


Figure 28: Frequency of saving
Source: FinScope, 2014.

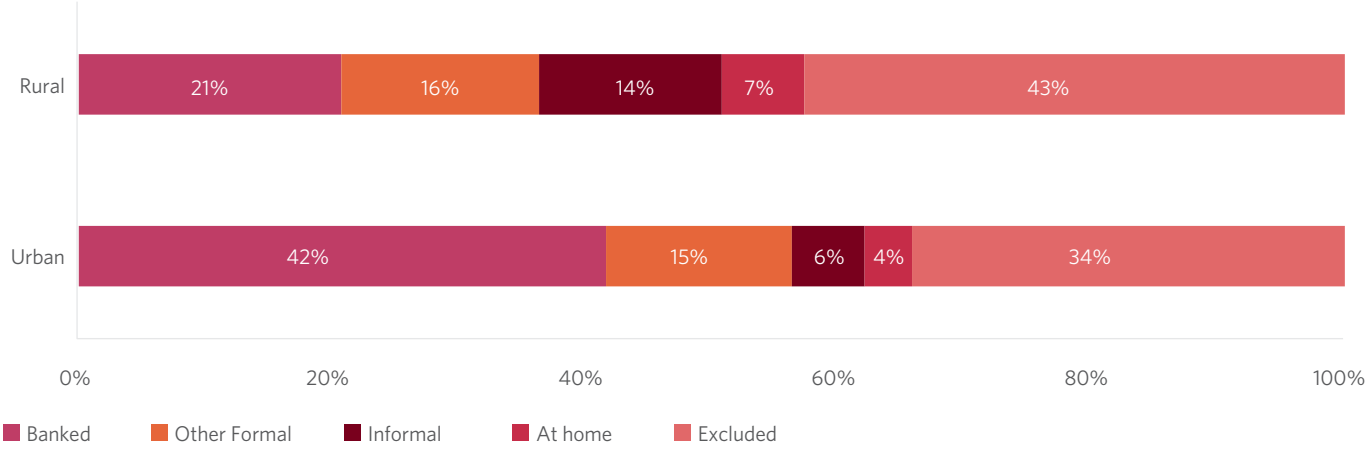


Figure 29: Savings access strand by location (rural/urban)
Source: FinScope, 2014.

Frequency of saving depends on the receipt of income. As illustrated in Figure 28, the majority of the population who save do so on a monthly basis. There are two main reasons for the popularity of monthly savings: one is that salaries and wages of the key target market segments (in terms of saving) are usually earned on a monthly basis, and people save what is remaining at the end of the month after meeting living and other expenses. It is estimated that the average Nepali household saves 14% of its monthly income (Nepal Rastra Bank, 2014, *Fifth Household Budget Survey*). The second key reason for monthly saving is that the structure of informal savings groups is based on regular savings payments, most often on a monthly basis (MAP qualitative study, 2015).

Urban population has better overall access to saving mechanisms. As shown in Figure 29, urban adults proportionally have better overall access to saving (34% of the urban population are excluded from saving, versus 43% of the rural).

Formal access levels higher in urban areas, while informal access levels higher in rural. Urban adults also have better access to formal savings services and products compared to their rural counterparts. A likely explanation for this is simply that many of the formal institutions are based in urban areas. By the same token, the level of informal uptake is proportionality higher in rural areas (up to 33% of rural adults, when overlaps are included).

In absolute-number terms, more saving is done in rural areas. When we consider absolute numbers, because most of the adult population is rurally based, across the board savings uptake is much higher in rural areas.

More females saving. If we examine the gender split in the uptake of savings products, we see that a higher percentage of adult females (61%) than adult males (56%) access saving mechanisms. This is significant, given that generally males have higher proportionate access to financial services.

The access point varies by gender. As with the overall trends of access in Nepal, males tend to have higher access to formal savings services and products while females have higher access to informal savings and saving-at-home options. The difference

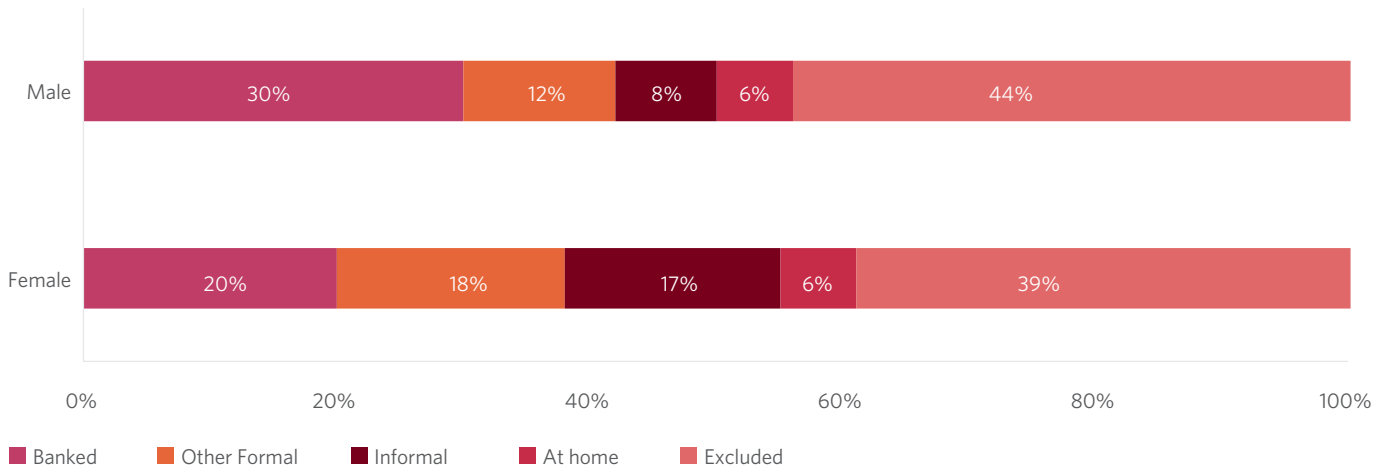


***Figure 30:** Savings access strand by gender*
Source: FinScope, 2014.

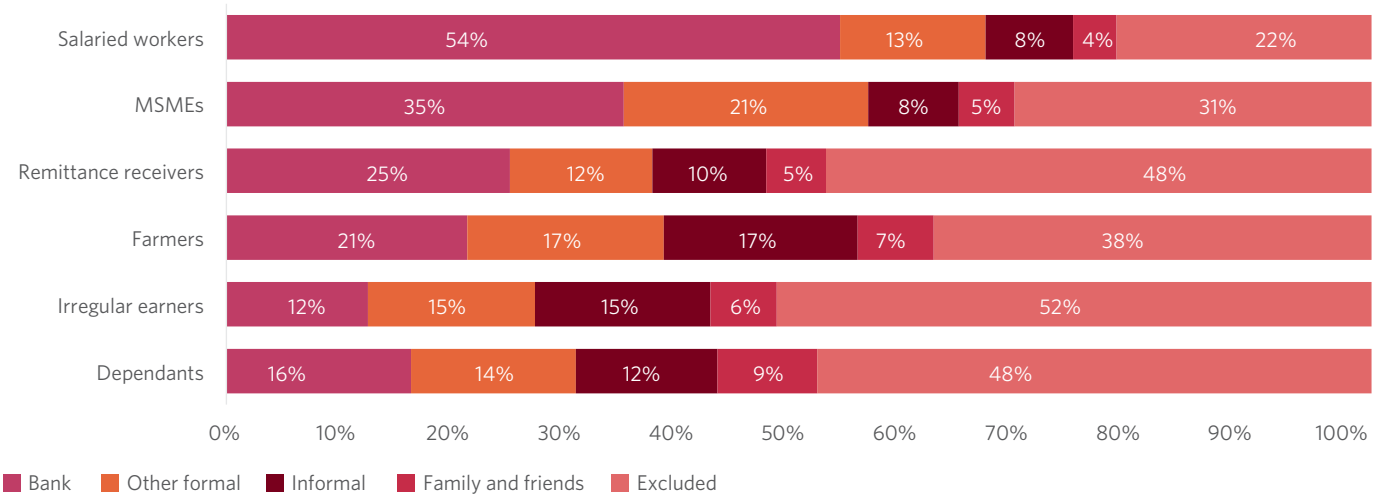


***Figure 31:** Savings access by target market*
Source: FinScope, 2014.

is particularly stark for saving through banks (favoured by males – males have 10% higher level of access through banks, overlaps included) and informal providers (favoured by females – females have 14% higher level of access to informal providers, overlaps included).

Higher-income segments make greater use of savings mechanisms. The level of savings varies considerably across target market segments. However, there appears to be a relationship between savings and income levels: over 78% of salaried workers and 69% of MSMEs – the target markets with the highest income levels – have access to saving. (For MSMEs, personal and family savings are generally their major source of business capital.) Particularly worth noting is the higher level of bank savings across these target market segments.

By contrast, only 48% of irregular earners and 52% of dependants – the target markets with the lowest income levels – save.

In absolute-number terms, the farmers segment has the most people saving. The 'higher income–greater use of savings mechanisms' is not, however, a totally consistent 'storyline', as shown by the fact that farmers have higher access to savings mechanisms than do the higher-earning remittance receivers. In absolute numbers, farmers will thus also have the largest number of adults saving. (Many farmers are in the habit of saving and then exhausting their savings to meet operational expenses.)

Why are people saving?

This section outlines the use cases for savings as identified through the MAP qualitative and quantitative demand-side research (2015). As evident in Figure 32, the top four reasons for saving are: consumption smoothing; risk mitigation (medical and other); education; and providing for old age and retirement. Additional reasons for saving that feature high on the list include investment, and providing for special occasions/events.

Use of saving for consumption smoothing. Saving for consumption smoothing means setting aside funds to meet living expenses and manage irregular cash flows. Figure 32 illustrates that 30% of adults in Nepal have used savings for living expenses when they did not have money at the time. Saving for consumption

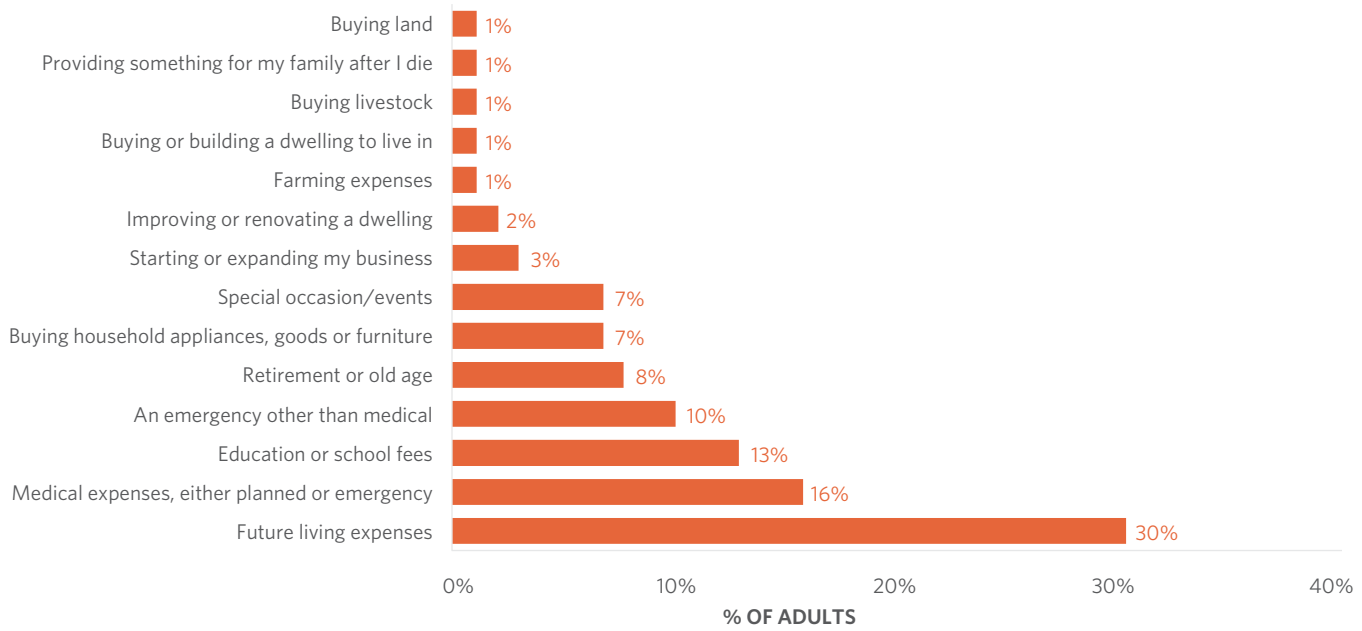


Figure 32: Use cases for savings in Nepal
Source: FinScope, 2014.

smoothing is the highest priority consistently across all of the target market segments.

Of the target market segments:

- Salaried workers (38% of salaried workers) and MSMEs (34% of MSMES) show the highest percentage of those saving to meet this need.
- In terms of absolute numbers, the farmers segment has the highest number of adults saving to meet this need (around 1.5 million adults).
- Saving for consumption smoothing is the lowest for dependants (24% of dependants) and irregular earners (26% of irregular earners).

The differentiation in groups appears to be driven by ability to save to cover consumption smoothing need, with a greater proportion of higher-income groups saving for this reason. Farmers are the one anomaly in this respect, a fact that is likely due to the seasonality of income creating the need to set aside funds to smooth consumption.

Use of saving for risk mitigation. Saving for risk mitigation means the accumulation of funds to absorb losses during risk events, whether expected or unexpected. Using savings to mitigate risks is a commonly cited purpose of saving in Nepal. FinScope (2014) revealed that the main risks covered by savings are medical emergencies – whether planned or unknown – (16% of adults), and emergencies other than medical (10% of adults).

In the Nepali context, generally adults use savings (rather than insurance) as the first financial service to mitigate the impact of risk events. (Insurance is currently limited to a few products, and medical insurance offerings are mostly limited to group schemes, which are again bundled with other insurance products.)

FinScope (2014), for example, found that in the past year, 39% of the adult population had experienced illness in the household, and 30% of these had accessed savings to cover the cost impact of the health risks experienced. While credit can be an alternative tool for mitigating risk (in the past year, 50% of those who experienced illness in the household had accessed credit to cover the cost impact of the health risks experienced), the cost of credit is extremely high.

Saving for a medical emergency correlates positively with level of income, which was highest for salaried workers (23%) and lowest for dependants (11%).

Use of saving for education. FinScope revealed that, of the total adult population who save, 13% save for the purpose of providing quality education to their children. Nepali adults consider education a vital investment to improve the situation of their children and, by extension, themselves (MAP qualitative study, 2015). General education levels in Nepal are low (54% of adults have a maximum of primary education); obtaining a full education for future generations is a significant aspiration. Hence each target market segment tends to save a portion of the household income for education.

Saving for education is correlated with the income of the target market segments, with the higher-income segments saving more to meet this need.

"Since the earthquake and this blockade my earnings have decreased, since there is no tourist; my current income is just enough to cover daily living expenses. Now I am depending upon my savings to pay for my children's education." (Boat rower, female, aged 45)

Use of saving for old age and retirement. According to FinScope (2014), 8% of adults save for old age and retirement. In Nepal, there is a culture of children and families in general providing support for their elderly relatives. This provides a general sense of security for retirement, and thus saving by individuals to cover themselves for this need is lower than might otherwise be expected.

The degree of saving for old age and retirement varies significantly across the target market segments, although higher-income target market segments save more towards this need. This pattern is understandable, given the trade-off at low-income levels that would be involved in providing for long-term needs at the expense of immediate survival.

It should be noted that the current saving levels for old age and retirement might be understated in FinScope (2014); this is due to the fact that, in the responses, salaried workers might have failed to take note of involuntary retirement savings through contributions to the Employees Provident Fund (EPF) and Citizen Investment Trust (CIT) mandated by their employer.

Use of saving for investment. Saving used for income generation or for generating a capital gain can be considered investment. FinScope (2014) indicates that adults across the target market segments use savings for investment purpose in one form or the other, across personal and business reasons: for example, the investment made to expand a business or acquire or upgrade assets (e.g. 7% of adults investing in household goods, or 2% of adults renovating a dwelling). In this regard, the highest usage of saving is in the form of investment made in household needs, particularly: education; buying household appliances and goods; buying land or buildings; building or renovating a home.

Saving to start or expand a business is largely driven by those earning their primary income from running a business (i.e. the MSME target market), although it is worth noting that only 3% are saving for this purpose.

The MAP qualitative survey (2015) indicates that target market segments that have steady income invest in the primary stock markets, a factor that is fuelled by a widely held perception of guaranteed high returns.

"I have invested my savings into buying shares of hydropower, because these days the stock market gives me a high return, which is way higher than any bank." (Government peon, female, aged 46)

Use of saving for special occasion/event. When it comes to life's special occasions or big events, these often have a large cost attached that savings can be used to cover. Of adults in Nepal, 7% indicated that they were currently savings towards a special occasion or big event. The MAP qualitative study (2015) noted that weddings are among the big events for which Nepali adults often put money aside.

What products are available and in use?

General trends and salient facts

Maintaining minimum balance prime reason for not having bank accounts. FinScope has shown that 57% of Nepali adult state that the reason they do not have a bank account is because they are not able to maintain the minimum balance. Interestingly, however, for quite a long time, Nepali banks have offered a zero-balance account to all (eliminating the need for maintaining a minimum balance) – and they continue to do so.

'Do not see the need'. Another 47% of Nepali adults do not see the need for having a bank account, and 21% say that providers are too far away/transportation makes it difficult for them to take up the service. One can assume that the perceived benefits thereof are outweighed by the perceived negatives (including lack of proximity and low rates of return – see below).

Low real rates of return offered by FSPs. While banks are key providers in the savings space, when compared to alternative providers, the banks offer low rates of return: figures of around 1% for short-term products and 5% for long-term products (Beed, 2016 – Product Provider Matrix). Taking inflation into account, savings in banking institutions actually yield *negative* real return, while other formal and informal institutions offer rates around 8% annually, which at least yields positive real returns.

It is worth noting that the MAP qualitative survey (2015) indicates that SACCOs are the only savings provider currently delivering real returns (Beed, 2016) – although it should also be noted that even at the slightly higher interest rate levels provided by these other formal providers, there is a risk of not beating inflation. The result is that many FSPs, and particularly banks, do not appear to be an attractive option for customers seeking a return on their savings deposits. This is especially with regard to longer-term savings, where the inability to beat inflation will mean savings values decrease over time.

Assets and shares as alternative saving instrument. As opposed to the official savings products from providers such as banks and MFIs, the assets and shares market has grown to be a reliable avenue for generating real returns. Assets in a competitive market space have the ability to take new information into account with their pricing; particularly, in this case, the impact of inflation. They are therefore likely to at least track inflation and, in some markets (e.g. the housing or jewellery market), provide highly competitive returns that beat inflation. The average return of the share market for the past five year is estimated to be approximately 22%. The cost to hold is equivalent to the interest earned on the savings account, which ranges from 3%–6%, including a capital gains tax of 5%.

The caveat in this respect is accessibility of these products. Assets are a channel for savings that are often more widely accessible in general, but can be limited when it comes to purchasing high-value items (such as a house) due to a lack of capital from low savings values or constrained access to credit. Also, as already mentioned, the stock market faces accessibility issues in terms of both physical access to the market, and a deficit

of sufficient shares for the level of demand that exists. With the IPOs in the market continually being oversubscribed, people are ever ready to invest in the share market with the hopes of higher returns (Share Sansar, 2016).

SACCOs and savings groups have mandatory savings. Unlike banks, the SACCOs and savings groups require their members to regularly deposit certain amounts at set intervals as prescribed by the particular savings scheme. Failure to meet this requirement would be met by some form of financial penalty; and, in some cases, credit provision also depends upon the savings done by the member (Seibel, 1988). Therefore, these institutions are developing the culture of savings through disciplining members to save more and at regular intervals, which perhaps would not have been possible if not for mandatory savings schemes.

Homogeneous savings product offerings, with FSPs often targeting the same market. Across the FSPs, the product offering is relatively homogeneous. This applies both to what can be counted as a 'standard' savings product type for providers, and to products that have been 'specialised' by targeting particular profiles of customers. With regard to the latter, most BFIs offer special kinds of savings account for women, children, and senior citizens respectively. These differ from the general savings products with regard to marginal changes in the interest rates, fringe benefits such as free ATM cards, mobile/Internet banking, and insurance coverage, among other things.

Savings deposit base of providers on a growth trend. There is a trend of growing deposits across the providers in the sector (Nepal Rastra Bank, 2014):

- In July 2014, the total deposits of *commercial banks* increased by 18%, compared to 17.6% growth during July 2013. (The total deposit reached NPR 1,204.4 billion – from NPR 1,020.8 billion in July 2013.) This is a continuation of a growth trend in deposits over the past five years.
- Similarly, total deposits of the *development banks* increased by 23% between 2012/13 and 2013/14, amounting to NPR 196.87 billion.
- *Finance companies'* total deposits grew by 6.5% in the same period.
- *Retirement funds* came in at a similar growth level to commercial banks (16.9% in the fiscal year 2013/14).
- Class D institutions (*MFIs*) saw a dramatic rise in deposit levels, with an increase of 52.9% in this period.

Short-term savings products

By 'short-term' savings products is meant those with a term length of up to a year. Short-term savings products are provided by most of the FSPs active in the savings space: banks, SACCOs and savings groups, and MFIs. In addition, we take a look at saving products offered by the stock market.

Products offered by the banks:

Saving deposit accounts: These accounts allow withdrawals on demand. Most of the banks have introduced low-balance or zero-balance accounts in an effort to capture lower-income segments. Saving deposits accounts earn interest of 2%–4% per annum on daily or monthly balances, depending on the formal institution. Commercial banks offer the lowest interest rate on saving accounts (average return is approximately 3.5%), while finance companies offer the highest interest on savings (on average 5%). As mentioned, almost all of these formal institutions offer a version of the accounts targeting a particular audience (typically, children, women, and senior citizens, respectively), and these target accounts usually offer a higher interest rate.

Short-term recurring deposits accounts: These include accounts in which savings is recurring in nature i.e. equal deposits are made at fixed intervals over a fixed period of time. The majority of the banks offer only short-term recurring deposits, at an average interest rate of 4%.

Short-term fixed deposits accounts: These include accounts where one-time deposit of a higher amount is made at the time of account opening. Currently, the majority of fixed deposit accounts are one-year maturity products with an option to renew. These accounts offer an average return of 5%–12%. Withdrawal from a fixed deposit account is not permitted during the locked-in period and a penalty is levied in case of premature withdrawal.

SACCOs and savings groups currently offer and deliver door-to-door services through collectors.

Some of the common SACCO and savings group products:

Compulsory saving: Under compulsory savings, members decide the minimum amount. The value generally starts from the low amount of NPR 10 (US$ 0.10) and goes up to NPR 1,000 (US$ 10.15) per month. The compulsory saving amount is usually higher in urban areas. A member cannot withdraw these compulsory savings unless they terminate their membership in a SACCO or until the agreed savings term ends in the savings group.

- In the case of cooperatives, a member can take a loan against 90% of the savings.
- In the case of savings groups, a member can get credit almost equivalent to the total deposit of the savings group (MAP Mystery Shopping, 2016).

Short-term fixed deposits accounts (SACCOs only): The interest on short-term fixed deposit accounts with a SACCO is higher than those held with banks at an average of 8%–12% (Beed, 2016 – Product Provider Matrix).

Other: Other products offered by cooperatives include emergency savings for medical expenses, pension savings, and single-purpose savings including festival, education and vehicle saving, among others.

Products offered by MFIs:

Compulsory savings: This is mandatory savings provided by MFIs linked to the loan disbursement. Clients are required to deposit a certain percentage (around 4%) of their loan disbursement in this account. This product is designed to encourage client saving habits. Typically, the interest on this kind of saving product is 6%–8%. Clients may withdraw from their account as and when required, usually being required to keep at least 10% of the loan outstanding (Beed, 2016).

Voluntary savings: A client of an MFI can open his/her account with a minimum of the small savings amount of NPR 10 (US$ 0.10), with interest of approximately 8%. The client may deposit and withdraw as needed (Beed, 2016).

Products offered by the stock market:
IPO and secondary market: With low returns on the majority of saving products, a significant proportion of the population are investing their savings in the primary market and secondary markets. As already noted, the market has yielded an average of 22% return over the past five years. The investment period can range between short and long term. This product has been included under short-term products on the basis of the fact that it offers the option of liquidating in the short term.

Long-term savings products

By 'long-term' savings products is meant those with a term length of over a year. These are limited to long-term fixed deposit products, recurring deposits, shares, or retirement funds investments.

The types of long-term savings products that are available include:

Long-term fixed deposits: Commercial banks, development banks and finance companies and cooperatives offer fixed-deposit saving products, with the interest varying per formal institution: commercial banks offer the lowest return (4%–5%); cooperatives offer the highest return (8%–12%).

Recurring deposit: This savings product is offered by SACCOs and MFIs and relies on regular deposits on a monthly, weekly or daily basis. Usually the FSP delivers door-to-door services through collectors. Recurring deposit are long term, ranging from 2–5 years. (Banks also offer recurring-deposit savings products, but only short-term ones.)

Shares: Members of SACCOs buy into the SACCO through the use of shares, which gain a return from the investment practices of the FSP. However, SACCOs are usually particularly focused on lending out funds.

Retirement saving: Pension savings are a form of savings earmarked for a specific purpose. The products are usually limited to only cashing out once an age or product maturity milestone has been reached. Retirement funds and MFIs alike offer specific retirement products:

- Retirement fund contributions are generally done on a monthly basis via deductions from an employee's salary. The employer will pay a portion of the contribution directly.
- Clients of MFIs deposit a certain amount as their pension saving at every meeting. Clients are offered the promise of having doubled their initial deposit amount under this saving product after the maturity of their savings. The interest on this doubled amount is provided to the member client as pension, or the member client can withdraw the whole amount. This product helps to ensure a certain amount of saving paid to the member client at a set age.

Retirement funds an important long-term savings vehicle. Retirement fund providers are the only providers exclusively focused on long-term savings provision in the market. To some degree SACCOs touch on this target market, due to their member model requiring customers to buy shares that are held for the duration of their membership, as well as saving in assets, which holds the potential for a long-term hold strategy. This makes retirement funds an important vehicle for long-term saving in Nepal. However, there are currently only two retirement funds active in the market and these are restricted to offering services to the employed sector.

Who are the providers?

Range of formal and informal providers active in savings provision. The providers of saving products can be classified into formal (regulated) institutions and informal (unregulated) institutions.

The formal financial institutions include: BFIs (i.e. commercial banks, development banks, finance companies, MFIs and SACCOs), pension funds, postal savings banks and financial non-governmental organisations (FINGOs).

Note that in terms of the Financial Intermediation by Societies Act (1999), NRB permitted the establishment of FINGOs, to provide saving and loan services to clients through MFIs. This Act had been instrumental in expanding the reach of financial institutions in rural areas. With the success of FINGOs, NRB has initiated a process to graduate FINGOs into BFIs and bring them into compliance with the BFI Act. FINGOs are currently in the process of being converted into MFIs.

As at mid-October 2015, there were 194 BFIs and 42 non-bank financial institutions licensed by NRB. Over and above this, there are approximately 13,460 SACCOs and 4,031 multi-purpose cooperatives (of the 32,663 cooperatives registered with the Department of Cooperatives). A further 15 SACCOs sit directly under the NRB's supervision.

The informal financial institutions include: village savings groups, *dhukuti* (financial self-help groups functioning as revolving credit associations) and informal savings groups.

Savings groups dominant provider by client numbers. Figure 33 gives an overview of the client numbers and average income levels per savings provider (although retirement savings were not considered in this measurement).

In terms of client numbers:

- Savings groups are the dominant provider: 31% of adults access savings through these institutions.
- Banks and SACCOs also hold dominance in the market (25% and 19% of adults, respectively).
- Interestingly, the next four providers in terms of client numbers are resources for saving at home (both monetary and non-monetary), which in combination also make this a key 'provider' in the savings landscape.

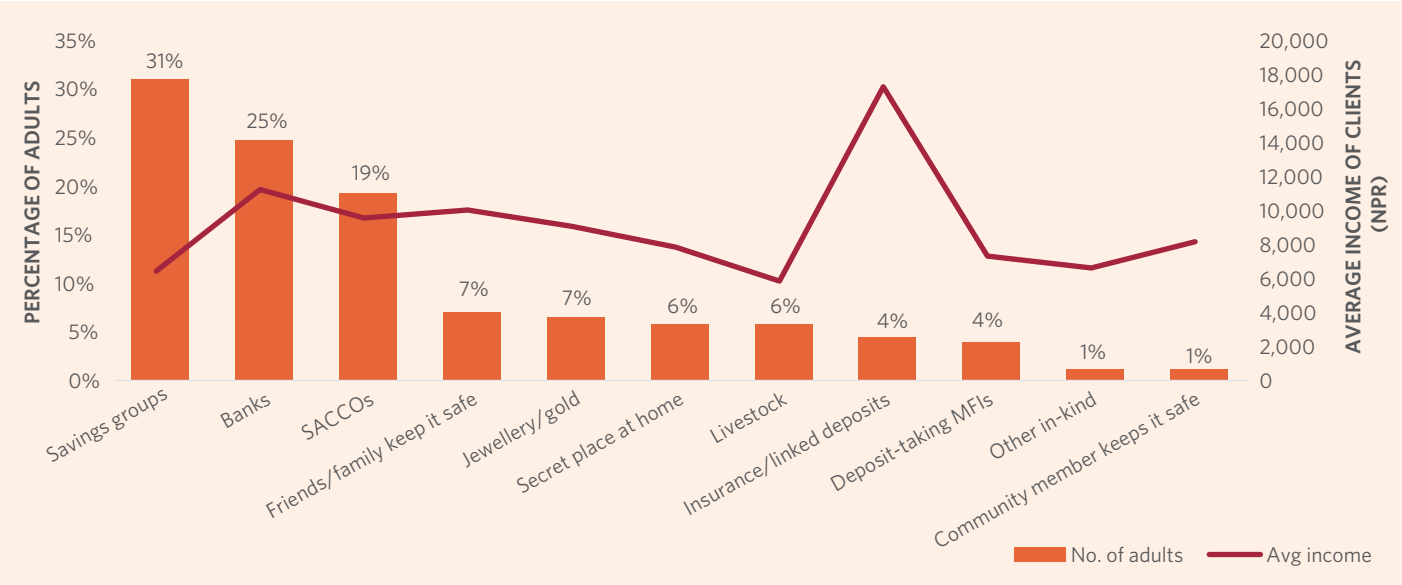


Figure 33: Overview of savings providers (client numbers and average income)
Source: FinScope, 2014.

Banks and insurance/linked deposits dominant by income. Average income level per savings provider are highest with banks and insurance/linked deposits. To quantify this: when providers are viewed in terms of the income of their depositors, banks are almost double the population's average income of NPR 6,669 (US$ 68), and insurance/linked deposits are almost triple the average income.

Average income values drop sharply for the locally based providers. However, only savings groups, livestock and the 'other in-kind' categories sit at or below the population's average income level of NPR 6,669 (US$ 68).

Commercial banks are the primary providers of formal saving products. As shown in Figure 34, commercial banks are the market leaders, with 72% of the overall savings deposit pool. Class B development banks are the second largest mobilisers of deposits, with 12% of the market share, followed by SACCOs (under the Department of Cooperatives) mobilising 11% of total savings deposits.

Savings deposit values held by informal providers are unknown – but likely lower in value. If one assumes both a correlation between depositors' income levels and the value of savings deposited, and that this behaviour would be replicated across providers, it is possible to take average client income levels as a proxy for potential value held in the provider; on that basis, it is likely that informal providers hold a lower-value savings deposit book.

Banks are most trusted institution to securely hold savings. When asked by FinScope (2014) which institutions they trust the most with their savings (although retirement savings were not included in this measure), adults responded as follows:

- 72% favour banks.
- 9% favour SACCOs.
- 7% favour savings groups.

This is interesting given the fact that this has not translated into stronger market dominance by banks, although current uptake levels are still significant given other barriers to bank access.

When it comes to groups, village savings groups are favoured. Despite the low level of prioritisation of savings groups, they are a key institution for saving. Of the various formats a savings group can take, the village savings group was noted as the most popular. Of those accessing savings groups, 91% favour the village savings group.

The MAP qualitative study (2015) indicated that people choose to save in savings groups due to their convenient proximity. Furthermore, these groups consist of friends, families and

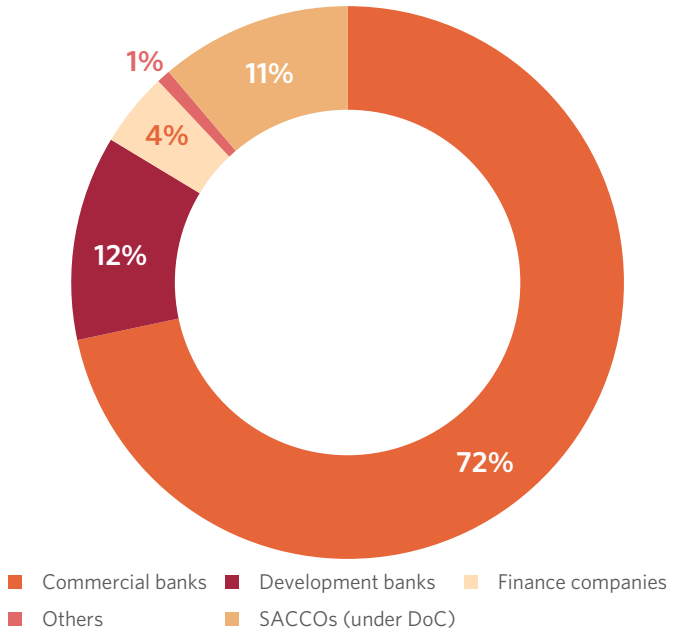


Figure 34: Formal savings providers' share of the market – by savings deposits value (2013/14)

neighbours, who know one another. Because of this, and because group members are likely aware of the problems faced by any particular member, the village savings groups – unlike formal institutions – are often flexible in terms of loan repayment. The groups make it possible to be fiscally disciplined and save at regular intervals, and they also unlock access to credit and insurance offerings, which are often available without the strict eligibility requirements of other providers, thereby removing a barrier that could hinder access from other providers.

"I do have a bank account in the district headquarters, but I prefer saving in our small village group because it is easy to save here. Travelling expenses are higher than the amount saved." (Weaver, female, aged 43)

Prestige is also a factor. Respondents to the MAP qualitative study (2015) indicated that there is a further element to be considered: that of the social prestige that can attach to being a member of a financially sound savings group.

Saving at home a significant and likely understated 'provider'. FinScope indicates that 16% of the adult population save at home. (This figure includes those that save with friends or family – including trusted community members – and saving in assets.) However, this figure is likely underestimated given the strong preference in Nepal for asset accumulation and transacting in cash, as established elsewhere in this report. One reason for such understatement could be that respondents to the survey do not view the assets they hold as savings, despite the potential of these to be liquidated to cover savings-linked needs. In terms of this understatement, it is also possible that cash held in short-term saving at home to fulfil anticipated needs might not have been reported in FinScope due to the short-term nature of such savings.

The stock exchange is a small-scale savings provider, with potential for growth. There is a fair percentage of involvement by individual (or retail) investors in the market. This means that the capital markets are another provider of savings for investment. Market capitalisation in 2014 was US$ 10.7 billion. While this is a substantial number, in relation to the value held by other providers it falls below the lower-level market players, such as the development banks (see Figure 34 to see this share of the market). The stock exchange is a provider that holds high potential due to the high returns that it can provide, but due to low market liquidity and barriers to increasing the size of listings, it is unlikely to be a key player in the market in the short to medium term. Access to the NEPSE is also limited: not even largely confined to those in urban areas but actually largely confined to those in the Kathmandu Valley; therefore the stock exchange sits beyond easy reach of the majority of the population.

Customers of locally based providers are more rural, female and hold lower education levels. Table 13 provides an overview of the profile of customers of some of the key savings providers (banks, MFIs, SACCOs, and savings groups).

In terms of the geographical split, with the exception of banks, which have 68% of their customers in urban areas, the providers have a majority rural customer base.

Savings clients are majority female for the locally based providers of MFIs, SACCOs and savings groups. However, banks have a greater percentage of male savings clients (57%). In a society in which 47% of the adult population is male, this is a significant skew.

In terms of education levels, MFIs, SACCOs and savings groups all have high proportions of customers with lower education levels (i.e. primary school or lower). In the case of SACCOs, their customers display a wider range of education levels: 47% have primary (or lower) education levels but 46% have secondary school level education. Banks are an outlier in this regard, with the bulk of their customers holding secondary school education (56%) and having the highest percentage among the providers of customers with tertiary education (13% of customers). One likely cause for this is the high percentage of salaried workers and MSMEs that use banks.

In terms of target market segment split of customers, all providers follow the uptake trend already discussed: of farmers forming the largest group of customers.

	Banks	MFIs	SACCOs	Savings groups
Rural	32%	83%	77%	87%
Urban	68%	17%	23%	13%
Male	57%	33%	42%	31%
Female	43%	67%	58%	69%
Primary or lower education	31%	59%	47%	59%
Secondary education	56%	36%	46%	38%
Tertiary education	13%	5%	7%	3%
Salaried workers	20%	10%	13%	8%
MSMEs	17%	12%	20%	11%
Remittance receivers	10%	3%	9%	10%
Irregular earners	8%	19%	11%	14%
Farmers	26%	38%	29%	37%
Dependants	10%	15%	12%	14%

Table 13: Customer profiles of savings providers (% total adults per provider)
Source: FinScope, 2014.

What are the barriers to usage of savings services and products?

There are many ways in which access to financial inclusion can be hindered. Two main groupings are access and usage barriers, respectively. Barriers to initially accessing a product could include, for example, issues of proximity, eligibility, affordability and appropriateness; while barriers to effective usage of the product could include issues of financial capability, trust and hassle/inconvenience.

Access barriers

Proximity is a key barrier for formal FSPs (excluding SACCOs). One of the most common barriers to financial inclusion through formal FSPs is the lack of proximity to their target markets. The mainly urban distribution touchpoints for all formal FSPs (excluding SACCOs) have served as a barrier for the majority of the population, who are concentrated in rural areas. To illustrate, the National Living Standards Survey 2010–11 shows that around 27% of households in the rural areas have access to a bank within a 30-minute distance, compared to the urban areas, where 89% of households are within a 30-minute distance from a bank. Hence proximity to formal institutions is a key barrier, particularly for rural adults.

While digital banking could help to overcome some of the proximity challenges, there are a number of prerequisites:

- Encashment infrastructure must to be in place to support digital infrastructure.
- The reliability of the telecommunications system needs to be improved.
- Telecommunications/banking overlapping areas of authority need to be clarified.
- The lack of mobile banking provider interoperability, which greatly reduces the convenience and value for consumers, must be addressed.

Opportunity cost of proximity challenges. The time and opportunity cost of having to travel to the nearest bank and use its services create an impediment to depositing savings in such institutions. (The opportunity cost here refers to the time an individual could otherwise have spent on productive activities that generate income.) This is particularly the case for target markets that do not earn an income unless they actively work for it. The issues of proximity, time and opportunity cost would be particularly pressing in the hill and mountain regions, where only 45% and 17%, respectively, of households are within an hour of a bank and where transportation is not easy.

Eligibility is a low barrier for savings. There are certain requirements that must be met and documents produced in order to take advantage of savings products in banks or cooperatives (Beed, 2016 – Product Provider Matrix). For example, a national identity card is required in order to open a bank account with any of the formal FSPS or to become a cooperative member. It is almost impossible for a person without a citizenship certificate to open an account with a bank or other formal institution or to become a member of a cooperative. Similarly, cooperatives only accept as members people who are locals of the working area of the cooperative; thus, for example, migrants to the area cannot become members of the cooperative unless they register as residents in that locale. However, proof of residence is not required by most of the formal institutions as this requirement is fulfilled by the citizenship card. Requirements like these thus stand in the way of access to savings products for people who cannot produce the required documents, although this appears to be a low barrier in Nepal.

Affordability and appropriateness low in locally based providers. One of the major barriers to savings is that most people cannot manage to save out of their earnings. A number of respondents in the MAP qualitative survey (2015) revealed that most of their income gets spent on household expenses and they are not left with any significant amount to save in banks or financial institutions.

However, there is evidence that even at low-income levels, saving is possible: for example, the small savings amounts of NPR 10–20 (US$ 0.10–0.20) that are collected as daily savings by many local cooperatives and village savings groups (MAP qualitative survey, 2015).

Affordability might, therefore, not be a strong access barrier if more appropriately designed products were on offer. Banks, especially class A–C institutions, do not currently offer any such products.

Usage barriers

Cultural structure influencing savings behaviour. Social and cultural factors also act as hindrances to savings. For instance, in families where it has been a customary practice to hand over all of the income of the family to the head of the household or a member of the family who handles finances, it is difficult for the members to break the convention and deposit their savings individually in bank accounts or cooperatives (MAP qualitative survey, 2015).

"We give all the household savings to my father-in-law and he keeps the money with him. This has always been the trend; we feel like if we deposit the money into the banks he will feel bad about it. That would be disrespectful." (Female farmer)

Trust issues a secondary deciding factor when choosing savings products. Trust is an important factor for savings, as clients need to have a level of trust in the fact that the institution or instrument storing their savings will do so in the manner they have signed up for and reduce the possibility of loss of savings. As already mentioned, some FSPs hold higher trust levels than others: 72% of the adult population reported trusting banks for saving over other providers. As validated by the MAP qualitative survey (2015), people trust banks because these institutions are registered and regulated by NRB. The trust factor is enhanced by an institution being registered and having official client-facing elements such as office buildings and computerised branches.

However, consumers still take the risk to save with 'less trusted' providers – a factor that indicates that trust is not a key barrier to savings uptake, despite being a key consideration.

Homogeneous savings products on offer. The range of savings products on offer from FSPs is relatively homogeneous and unimaginative, with little to cater to the varying and unique savings needs of the different target market segments. In addition, rural dwellers with a relatively high level of financial function within their local community will tend to be quite limited in their product choice, even where the products available offer perceived benefits.

Perceiving formal FSPs as 'not for me'. The perceived value of savings also acts as a barrier for many to accessing formal institutions. Although many of the formal institutions have zero-balance accounts targeted at the mass market, many people with low incomes feel that banks are for high-value saving and that the value of their savings is too low for formal institutions.

Low real returns reducing the value proposition of saving with formal FSPs. Most formal FSPs provide savings products with negative or close to negative real returns; it is not surprising that this reduces the value that saving in these providers can offer, especially over the long term.

What regulatory and policy issues need to be considered?

Interest rate restrictions a barrier to valuable returns on savings. As per the unified directives issued by NRB, class A, B and C institutions are free to fix interest rates for both deposit and lending, including procedures surrounding this, on their own (Nepal Rastra Bank, 2010). However, the directives also mention that licensed institutions shall implement the interest rates for deposits only after approval. Furthermore, licensed institutions may increase the interest rate for deposits up to 0.5% over the published rate. Therefore, while a level of freedom is provided, banks are restricted to operating within a small range of return on savings.

This holds the risk of constraining the ability of banks to offer attractive returns to the market if it turns out that the regulatory level does not provide sufficiently for this. The evidence regarding negative real returns discussed already points to the fact that this could be the case at present.

Limited regulation and supervision of SACCOs. SACCOs are currently regulated by the Department of Cooperatives under the Ministry of Agriculture and Cooperatives. However, the large number of cooperatives makes effective regulation and supervision of SACCOs a major issue of concern. This is an important consideration: while SACCOs provide a valuable lifeline for savings to often underserved customers, these depositors remain highly vulnerable to loss of their savings. This is because, with SACCOs, there is no consumer protection in the form of deposit insurance and no recourse in the case of consumer abuses. The Department of Cooperatives is severely constrained by a lack of capacity, which limits the ability of this regulator to efficiently oversee such a large industry. There is a need to come up with a framework for appropriate regulation and supervision of the thousands of SACCOs spread across the country.

Restriction on MFI access to public deposit base. The unified directives issued by NRB to licensed banks and financial institutions (2010) stipulate that in order to mobilise public deposit, MFIs must fulfil conditions prescribed by NRB, including approval by the central bank.[1] However, instances of this approval are virtually non-existent. The result is that most MFIs are barred from accepting public deposit. Activation of this provision would increase MFIs' flexibility in terms of expanding their loan portfolio, improving outreach and expanding services and products. Furthermore, the presence of savers would improve governance through adding consumer pressure on the management of MFIs to conduct a prudent operation, which could lead to increased public confidence in and improved stability of the institution.

Insufficient deposit insurance coverage versus limited coverage. Deposit insurance, which protects depositors against the loss of deposits placed with BFIs in the unlikely event of the BFIs' failure, is limited to class A–D banking and financial institutions. The premium rate is fixed at 0.2% on guaranteed deposit. However, the coverage is insufficient as it is limited to NPR 200,000 per depositor per member institution on a combination of saving and fixed deposit. Furthermore, the MAP qualitative survey (2015) indicates that the premium rate for deposit insurance is moderate, and there is fear that BFIs may take greater risk with depositors' money because they can pass negative consequences on to the deposit protection agency.

By contrast, the cooperatives are key savings providers for the low-income groups and yet are not mandated by the Department of Cooperatives to provide insurance coverage for deposit. This makes a large population of low-income depositors extremely vulnerable.

Legal identity to informal savings groups. There are numerous informal savings groups, such as village savings groups, present in rural and urban areas alike. However these savings groups lack formal identity or are not registered with any government institution. While they do not pose a systematic risk that would require prudential supervision, formalisation through registration could assist these groups with connecting to formal financial services providers, and would provide an entity against which recourse is possible should consumer abuses occur. Registration with a government institution, such as the village development committee, could offer some protection to village savings group members.

What and where are the gaps and opportunities?

A committed culture of saving. The fact that Nepal already has a strong and firmly entrenched culture of saving, across all of the target market segments (including those with extremely low incomes), bodes well for growing the market for savings and ensuring that the unique and varying needs of different consumer groups are better catered for.

Increasing income levels provide potential for continued savings growth. In recent years, Nepal has managed to halve the percentage of people living on less than US$ 1.25 a day – from

half to a quarter of the population. This indicates that population income levels are on the rise: for example, per capita income increased from US$ 78 in 2004 to US$ 195 in 2011 (Asian Development Bank, 2013). Increasing income levels translate into increased opportunity for savings – particularly given the country's strong existing savings culture.

However, mind the income–expense mismatch. It is worth noting that, as a result of high remittance inflows and aspirations of upward mobility on the part of the population, Nepal is becoming increasingly consumption oriented, with a tendency to use credit to buy household appliances, white goods and furniture. The result is growing over-indebtedness. While the *Fourth Household Budget Survey* indicated household savings at an average 44.76% (on a monthly income of NPR 27,391), the *Fifth Household Budget Survey* indicated household savings down to 13.92% (on a monthly income of NPR 30,121). This indicates a negative saving culture leading to an income–expense mismatch (Nepal Rastra Bank, 2014).

Huge need for formal, accessible low-value saving products. The inability to save has been stated to stem from the fact that the majority of the population sit at low income levels and many (59% of adults) have no money left after meeting living expenses. Products that can assist saving at this level – i.e. targeted, low-value savings products – are limited in formal institutions. This, coupled with challenges of proximity, create a gap in provision by formal providers (with the exception of cooperatives) in this space, and this gap is currently being served by the informal market. This creates two possible opportunities for formal providers: to become competitors in this space (e.g. by improving their distribution); or to provide products (e.g. group savings products) to the informal institutions that have existing strong relationships with their savings customers. Finding appropriate instruments to accommodate small-value, irregular savings should be the policy focus, in order to allow people to better manage their own futures.

Committed savings products a driver for longer-term savings. Committed savings accounts are useful for saving money for future use by guarding against the temptation to spend it before reaching the goal. Savings products with commitment features can boost saving (as seen from the discussions of savings groups, for example, which emphasise regular savings and thus fiscal discipline on the part of members). Committed savings vehicles are thus useful for target groups with specific preferences as they facilitate saving for investments or for meeting expenses at a specific time in the future (e.g. education, school fees, a wedding) or saving to smooth consumption – all of which tie in well with the top reasons that Nepali consumers save.

It is already known that farmers are the most avid savers out of the target market segments, and have the pattern of saving but then exhausting their savings in funding their operations. They are thus presumably already using a form of committed savings, albeit sometimes informal or at home. Formal FSPs could investigate whether it is possible for them to offer this target market segment committed savings products with additional benefits or better returns than they are currently getting.

Use of technological innovations to improve saving. Technological innovations present opportunities to improve access to savings mechanisms, especially in more remote, rural areas where consumers cite lack of proximity as a barrier to taking up formal savings mechanisms. Providing banking and financial services through bricks-and-mortar branches can be expensive for BFIs, and the use of branchless banking agents or mobile money has the potential to change the way individuals access money, often in ways that reduce their financial or time costs. Leveraging digital channels, including the current expansion of mobile network coverage, and forging partnerships could reduce such barriers.

As mentioned in the section of this report on the market for payments, mobile financial service providers (MFSPs) such as Hello Paisa currently provide mobile money accounts that are not linked to a bank account, which allow the customer to deposit and withdraw cash from their mobile account. Cash-out is done through a cardless cash system from member bank ATMs. Deposits and encashment through POS/POT machines make the usage of payment channels cheaper for the stakeholders, while growing the volumes of transactions, which in turn starts to present a more attractive business case.

Crucially, providers of digital savings innovations will need to take into account existing challenges, such as: regulations that currently prevent *banks* from allowing digital payments and money transfer for people without an account and with only a phone number; the need for expanded existing encashment infrastructure; lack of interoperability on the part of MFSPs; the unreliability of the telecommunications system and, related to that, the need to grow consumers' trust in digital banking mechanisms; and overlapping areas of authority for the telecommunications versus banking industries, which creates confusion for providers.

Trust of the population highlighting opportunity for the formal FSPs to increase outreach. It has been established that a large section of the adult population trust formal institutions, particularly banks, for saving. Yet, this has not translated into these banks being key providers for savings (despite the fact that they are dominant). This provides an opportunity for the formal institutions to leverage the trust factor for increasing their outreach and market share.

However, tackling the significant existing barriers is a prerequisite for increasing outreach: lack of proximity; the low – sometimes negative – returns offered on savings accounts; and formal FSPs' inability to communicate at a level that the mass market can understand.

Opportunity to provide long-term saving products. The majority of the savings products offered by providers are short-term products with low levels of return; long-term savings products

are limited to two retirement funds and, to a lesser degree, MFIs and SACCOs (shares in the SACCOs). Furthermore, retirement funds are inaccessible to all target market segments outside of salaried workers (with some exceptions for MSMEs).

While there is a level of substitution for long-term monetary savings through community support and saving in assets, a market opportunity to assist individuals with saving to provide for their and their family's long-term future certainly exists. The increasing income levels generally will increase the magnitude of this opportunity, given the potential for higher surpluses that can be prioritised for long-term needs (over short-term priorities).

FSPs to link to informal savings groups. Savings groups often offer a stable and cost-effective springboard from which poor individuals can start a journey to financial inclusion. Linking informal savings groups to formal financial service providers potentially provides huge opportunities for fostering greater financial inclusion. (However, it is important to proceed with caution, as members of savings groups in rural areas are often ill equipped to deal with formal service providers and there is high risk of consumers being manipulated by intermediaries.)

Tapping into a significant customer base, in need of improved product offerings. Savings groups are subject to substantial risk of theft of member savings, as well as risk of limited, short-term savings options. Linking savings groups with formal providers would provide an opportunity for the groups to access longer-term savings and credit products, as well as to safeguard members' savings. Linkages would enable longer-term, lump-sum savings opportunities – and, over time, data captured digitally could expand formal borrowing options for individuals within the savings group.

For the provider of these products, this would represent an opportunity to link into the customer base covered by locally based FSPs through the central point of an existing group.

Opportunity for savings product innovation and tailoring. The characteristics of savings groups often require formal financial service providers to develop new, unique products that suit the group needs (Care, 2013).

The need to provide more perceived value to clients. As highlighted, those who save with cooperatives are in addition able to take a loan against 90% of the savings, while savings group members are able to get credit almost equivalent to the total deposit of the savings group. Furthermore, SACCO are offering higher interest on short-term fixed deposit accounts than those held with banks. These levels of benefit to savings clients contrast sharply with the low real returns that banks offer on their savings accounts. Banks could review the benefits they are able to offer savings customers, and also consider whether they could bundle benefits to provide savings depositors with better value.

Leveraging MFIs for increasing access to savings. In recent years there has been significant growth of MFIs in the country, in terms of numbers and geographical reach alike. This has resulted in coverage to many of the rural areas. Yet, despite their extensive network and reach in rural areas, MFIs have not been able to mobilise public deposit, due to regulatory issues prohibiting this action. If regulations were relaxed subject to fulfilling the conditions mentioned by the central bank for mobilising public deposit, MFIs could become another option for saving for a large section of the population. This is particularly important for a provider that often battles to source sufficient and cost-effective sources of funding for their credit portfolio.

Notes

1 Nepal Rastra Bank, "Regulation and Supervision of Microfinance Institutions in SAARC Region, 2013".

The market for credit

Summary

- There is low *uptake* of formal credit despite increasing *access* to formal credit.
- The majority of credit (measured by value) is provided by the banks. However, they have limited incentive to move downmarket and provide loans to riskier target markets.
- Under NRB's deprived sector lending directive, MFIs have been working to fill this gap and increase access to credit in the rural areas.
- The primary use of credit among the Nepali adult population is for consumption smoothing.
- Most people who borrow do so from informal providers, as they are not eligible to borrow from formal providers or they need instant access to loans; 28% of the adult population access credit from informal providers.
- Asset-based lending makes up two-thirds of the value of consumer credit, but serves a relatively small proportion of the market.
- The cost of credit makes it unaffordable for most unbanked adults in Nepal (e.g. MFIs charge interest from 18%–36% per annum).
- Macroeconomic conditions, lack of reliable and comprehensive information on borrowings (including multiple borrowings, accessing one loan to repay another/over-indebtedness), and consumer difficulty in fulfilling documentation and collateral requirements constrain credit provision.

Context

Despite exponential and diverse growth in the financial sector over the past two decades, and various reforms and regulations focused on and directed towards developing credit programmes for agriculture, small businesses and low-income households, access to credit remains limited for many people in many parts of Nepal. Up to 53% of the population do not have access to any form of credit (Ministry of Finance, 2014/15).

Demand not currently met by formal providers. While borrowing patterns indicate an underlying demand for credit products among Nepali adults, this demand is not currently being met by the formal providers.

What credit is used, and how?

Domestic credit as a percentage of GDP increasing slowly. Figure 35 shows that the amount of domestic credit provided by the financial sector (banks and other formal providers) as a percentage of GDP is increasing over time.

Limited uptake of formal credit. Figure 36 shows that around 18% of adults (2.9 million) take up credit through formal providers, and there is only a marginal difference between their sources of credit from banks or 'other formal' channels. Other formal channels are becoming popular because their loan application/approval process is easier and more lenient than that of banks.

Bank credit strongly skewed towards urban areas and market centres in rural areas. The class A banks dominate the total credit market in terms of value. For this reason, they have been able to serve the corporate clients and the larger population in the urban areas as well as those in the market centres of the rural areas.

FinScope (2014) shows that:

- Around 21% of urban adults access credit from banks and formal channels.
- Only 17% of rural adults access credit from banks and formal channels.

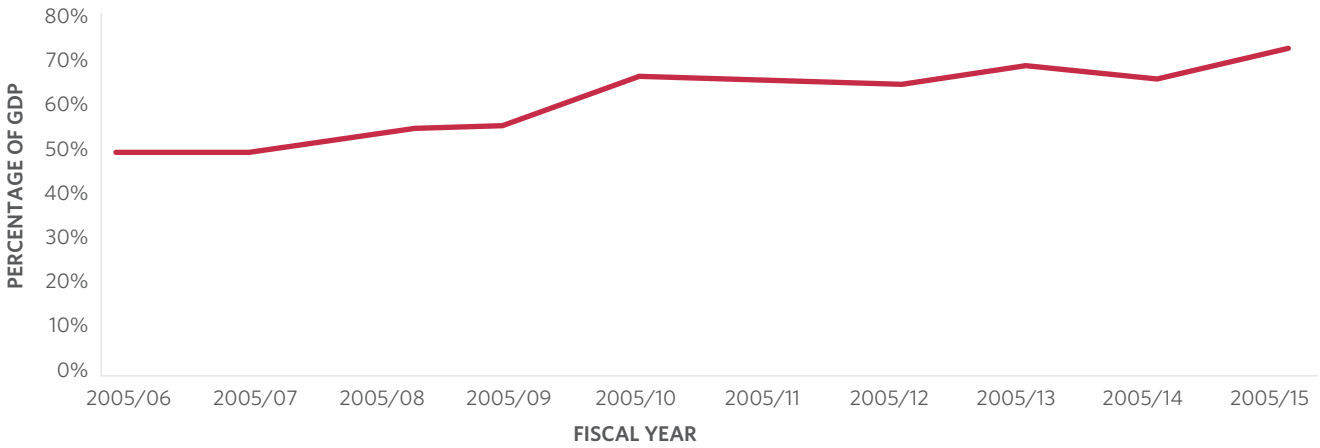


Figure 35: Total domestic credit (banks and other formal providers) as a percentage of GDP

Source: Ministry of Finance, 2014/15 (Economic Survey).

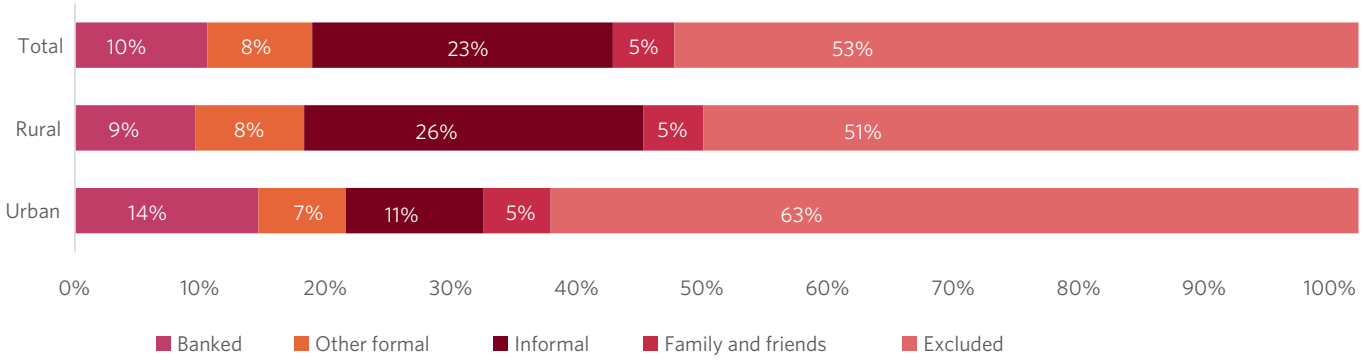


Figure 36: Credit access strand (rural/urban split)
Source: FinScope, 2014.

This indicates not only the predominant focus by class A banks on higher net-worth individuals and corporates, both groups more likely to be located in urban areas, but also the possible existence of barriers to formal credit uptake on the part of the much larger rural population, who have lower incomes. Borrowing from formal providers entails supplying documentation, providing collateral to secure the loan, and enduring delays in processing the application.

In the MAP supply-side qualitative interviews with the class A banks, they highlighted the following barriers to expanding credit services in the rural areas: low value and volume of loans, poor quality of assets to secure loans, and high administrative costs (banks charge processing fees up to 1.5% of the value of the loan). Under the deprived sector lending directive, MFIs have been working to fill this gap and increase access to credit in the rural areas.

Formal lending requires assets as collateral. The banks only provide loans against collateral, and the amount of the loan is dependent on the distressed value determined by the valuator. Banks disburse up to 80% of the distressed value as the loan. The regulator has permitted banks to disburse loans up to NPR 1.5 million (US$ 15,223) without collateral; non-collateralised loans above that need to be provisioned (Nepal Rastra Bank, 2014). Furthermore, proof of regular income is required. With the exception of salaried workers and MSMEs, the target market segments do not have access to such loans.

High uptake of informal credit services and products. FinScope (2014) indicates that only 18% of the country's adult population access credit through formal channels, compared to the 28% that access credit from informal providers. The fact that a substantial portion of adults access credit through other channels indicates that the limited uptake of formal credit is not due to insufficient demand for credit.

FinScope (2014) indicates the following about informal credit:

- 29% (4.4 million adults) take up informal credit services (this excludes borrowing from family and friends).
- Informal credit uptake is more common in the rural areas (32% of rural adults).
- Borrowing from moneylenders (who are informal providers) or from informal savings groups is significantly more common than borrowing from family and friends. The tendency to access credit from family and friends is not very common (about 8% of the adult population: 1.2 million adults).
- The credit from informal providers is more expensive than that from formal providers.

These borrowing patterns indicate an underlying demand for credit products among Nepali adults that is not currently being met by the formal providers. The high reliance on informal credit services can be attributed to the fact that accessing credit from formal providers is more onerous and/or that the informal credit products/services available are more appropriate to people's needs despite the fact that credit from formal institutions is significantly cheaper.

Salaried workers dominate formal credit. The most prevalent users of formal credit among Nepal's target market segments are salaried workers. As illustrated in Figure 37, 31% (400,000) of salaried workers access credit from formal providers; salaried workers, despite comprising just 10% of the total population, represent 15% of total formal credit users. As the target market segment with the highest average income and the most regular income, they have the highest levels of access to formal credit providers.

Urban salaried workers use bank credit more; rural salaried workers prefer other formal providers. Compared to salaried workers in the rural areas, urban-based salaried workers favour banks over other formal providers. Salaried workers in urban areas have more opportunity to access multiple formal providers and are able to choose from a wider product range. In the rural areas, although overall credit uptake from the formal sector is in line with that of the urban population, salaried workers seem to favour the other formal providers: 21% of salaried workers in the rural areas opt for credit from other formal providers compared to 9% of the salaried workers in urban areas. This is mainly attributed to less stringent requirements on the part of the other formal providers in the context of more limited options in rural areas.

Exclusion from/low uptake of credit by MSMEs, remittance receivers, irregular earners and dependants. Of the target market segments MSMEs, remittance receivers, irregular earners and dependants, 50% or more are totally excluded from credit

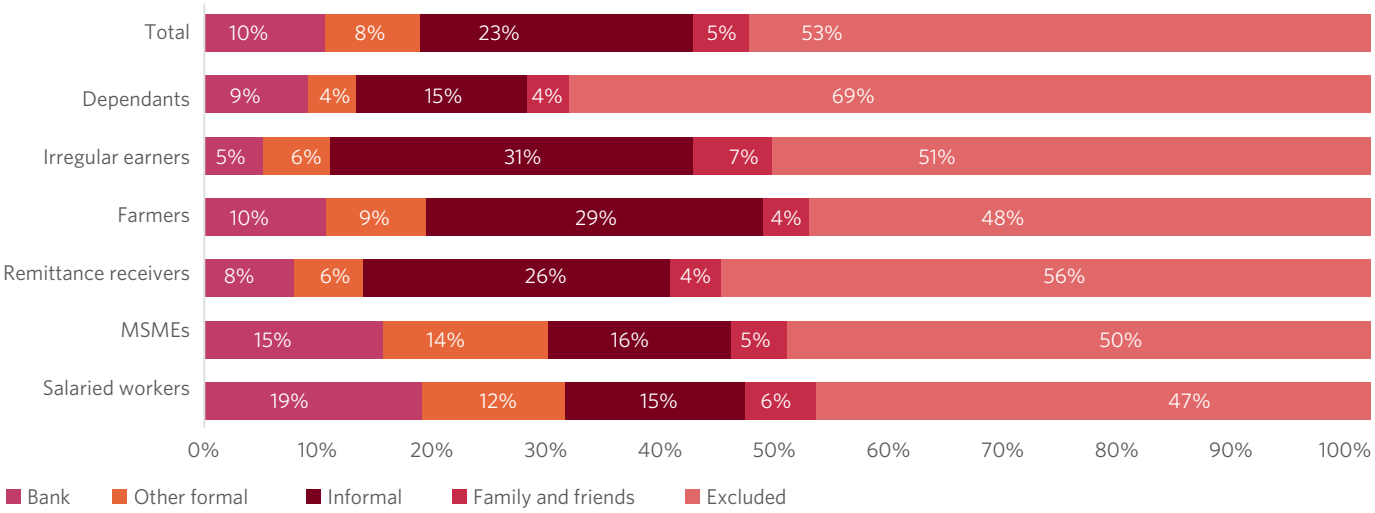


Figure 37: Credit access strand by target group

Source: FinScope, 2014.

services or products (including borrowing from family and friends). And, with the exception of the MSMEs, the people in these target market segments who are not excluded borrow more from the informal sector.

Farmers target market has a moderate uptake of credit but mostly from informal sector. About 52% (2.4 million adults) of farmers have access to some form of credit. In Nepal's agricultural sector, most of the farmers have small-scale operations or practise subsistence farming. Due to the seasonality and irregularity of income, they have limited access to credit from the formal sector (about 19% use formal credit). This is despite the fact that farmers are the target beneficiaries under the productive sector lending policy of the government, in terms of which the government has extended provision of refinancing loans given by the formal providers to the agricultural sector from NRB at 4% (Nepal Rastra Bank, 2014). In the absence of appropriately designed and structured credit products based on the provision, however, and given the constraints of infrequency and irregularity of income, farmers have little choice but to borrow from the informal sector: about 36% of farmer credit is informal (when overlaps are taken into account), from local merchants and local moneylenders. Such loans are generally taken for consumption smoothing and social rather than productive purposes.

Informal farming credit taken sometimes linked to a contract farming arrangement. Farmers sometimes take loan/s from traders, merchants, wholesalers or retailers to whom the farmer normally sells the produce, in return for a specified portion of the harvest at a pre-determined rate, irrespective of market prices at the time of harvest.

Formal credit more popular with trading farmers. Of the farmers target market segment, 75% are subsistence farmers (3,473,704 farmers) while 25% are trading farmers (1,147,070 farmers). Of the trading farmers, 24% (versus 18% of subsistence farmers) access formal credit.

Over-indebtedness, and inadequate information. There is no comprehensive and up-to-date record available of over-indebtedness, because there is no information on borrowings from formal non-bank sources (mainly the MFIs and cooperatives). Furthermore, the Credit Information Bureau currently stores only limited data on borrowers from banks and then only for loan amounts above NPR 1 million.

The MAP qualitative interviews found that people borrow money from both formal and informal sources; the fact that consumers access credit from multiple sources means that a portion of these individuals may be over-indebted and accessing one form of credit to repay another. This was evident during the qualitative interviews mainly within the target market segments of remittance receivers, farmers and irregular earners, borrowing from cooperatives and MFIs.

Incomplete credit records are therefore of limited usefulness and could pose a significant risk to financial institutions if relied upon.

How are credit services and products currently being used?

This section outlines the use cases for credit, as identified through the MAP qualitative and quantitative demand-side research.

As evident in Figure 38, the top three reasons for taking out credit are: consumption smoothing; risk mitigation (medical and other); and buying household goods or furniture. Also high on the list is education/school fees.

Use of credit for consumption smoothing. As shown in Figure 38, the primary use of credit among the Nepali adult population (32% of the total adults with credit) is for 'living expenses when you do not have money at that time'. All six of the target market segments indicated that consumption smoothing is the primary reason that they borrow. Consumption smoothing would be an imperative for the target market segments earning irregular

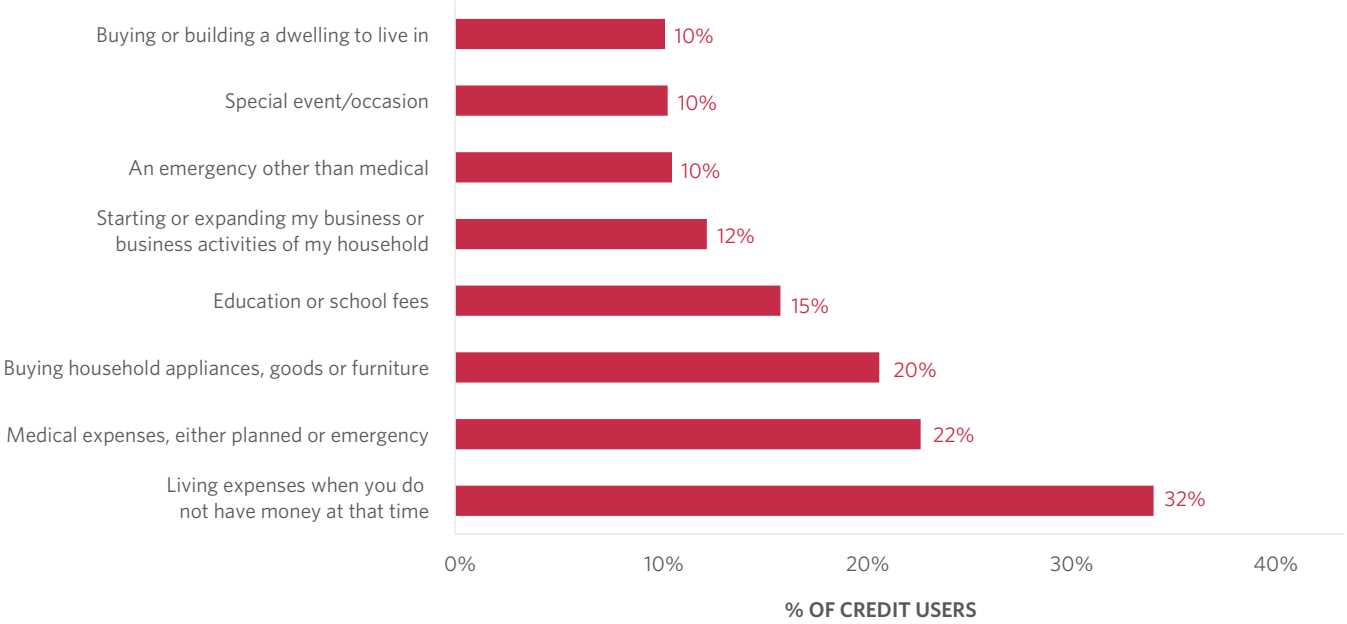


Figure 38: Reasons for taking out credit (as a % of total credit users)
Source: FinScope, 2014.

and/or low income – which constitute a large proportion of the total population. This was confirmed by the qualitative research, especially in the target market segments of farmers, remittance receivers, dependants and irregular earners.

Borrowing for consumption smoothing is also seen with members of the target market segments salaried workers and MSMEs (i.e. those segments with regular and higher levels of income) – and in these cases is attributed to high expenses during festivals, or over-indebtedness arising from pursuing aspirations of owing a vehicle or a house, which is seen as a matter of prestige in the wider society.

Use of credit for risk mitigation. Using credit to address risks that arise for individuals is common in Nepal. Due to limited income and low liquid savings, most of the people in the target market segments borrow to deal with risks and emergencies.

FinScope (2014), for example, found that in the previous year, 39% of the adult population had experienced illness in the household, and 50% of these had accessed credit to cover the cost impact of the health risks experienced, despite the fact that the cost of credit is extremely high.

Figure 38 shows that 22% of adults with credit use it for medical expenses and emergencies, and 10% use credit for non-medical emergencies. (Of adults with credit, 3% use it for funerals.) Due to a lack of good medical facilities, even in the urban areas, people often travel to the capital for treatment. At times they may need to go to a private hospital, where they are required to foot the bill for medical expenses. There is also a common practice of going abroad, mainly to India, Bangkok or Singapore, for medical treatment. Such events affect people's incomes and in the absence of health/medical insurance put a heavy financial burden on the household.

Use of credit for buying household appliances, white goods or furniture. As in any emerging economy with a growing middle class, especially economies backed by strong remittance inflows (remittance inflow in Nepal in 2014 stood at US$ 4.45 billion, as per NRB), in Nepal people's lifestyles are changing, with increasing levels of individual aspiration, and peer and societal pressure. Furthermore, with household appliances, white goods and furniture available on credit via easy repayment plans, people are borrowing to buy these goods, with approximately 20% of all credit users using credit for these purposes.

As a result, the country is becoming increasingly consumption oriented, leading to over-indebtedness. The *Fifth Household Budget Survey* showed that household savings had fallen to 13.92% (on a monthly income of NPR 30,121), compared to 44.76% (on a monthly income of NPR 27,391) during the *Fourth Household Budget Survey*. This indicates a negative saving culture leading to an income–expense mismatch (Nepal Rastra Bank, 2014).

Use of credit for education. Of Nepali adults accessing credit, 15% use it to pay for education or school fees (FinScope, 2014). The MAP demand-side and qualitative research indicated that education is seen as a key enabler to the future success of individuals' children and is a priority for people across the target market segments, to the extent that they would not mind using credit for such purposes.

The majority of credit used for education is likely to be for secondary school and/or tertiary education, as primary school (up to grade 5) is compulsory and free, while the remaining years of schooling (up to grade 12) are free at government schools. However, the cost of textbooks, stationery and school uniforms must still be covered by parents. Furthermore, given low standards of education offered by government schools, people prefer to send their children to private schools in the urban areas, which means an additional financial burden for boarding

expenses. The government covers tertiary tuition costs of a pre-determined number of students through scholarships; not all students receive these scholarships and even those who do still have additional expenses (textbooks, living expenses).

Borrowing to pay for secondary education is usually a short-term income-smoothing type of credit. But when it comes to tertiary education, due to its high cost the credit facility is usually long term. In addition, parents and families leverage their assets to access loans to provide for tertiary education (CEDA, 2007). Even though there is a high demand for educational loans, they fall under the consumer loan portfolio of the banks, with no special provision for education, and are treated the same as any loan against collateral (Upadhyay-Dhungel & Lamichhane, 2011).

Use of credit for personal asset purchases and mortgages. FinScope shows that 10% of Nepali adults with credit use it to buy a building or dwelling to live in, 2% use it to improve or renovate a dwelling and 1% use it to buy a mode of transport. The high cost of items such as motor vehicles and houses – for household and/or business use – typically means that individuals do not buy them outright, and hence credit plays an important role in funding such purchases. Owning a house and/or vehicle is a matter of social prestige and these are the first items to be aspired to by most consumers. Furthermore, most of the formal providers make easy credit available for such purchases, using the purchased house or vehicle as collateral.

Use of credit to pay off loans. Though the demand-side research did not reflect borrowing to pay off loans as being among the key usages of credit, in the MAP qualitative survey (2015), across all target market segments (except salaried workers), borrowing for paying off loans emerged as a key usage of credit. Especially given that small credit is easily available from MFIs and SACCOs, people borrow from multiple institutions (Shrestha, 2009). Borrowing to pay off existing debt is a clear indication of over-indebtedness. In the absence of credit information on the borrowers from MFIs and SACCOs, it would nevertheless seem that over-indebtedness could be a widespread problem.

The target market segments of remittance receivers, irregular earners, dependants and farmers (3%), were seen to access credit for the purpose of paying off loans.

Use of credit as asset and trade financing for enterprises. FinScope (2014) indicated that 5% of the adult population (0.77 million adults) obtain credit for the purposes of starting or expanding their business enterprises. Most Nepali MSMEs are micro businesses, employing only the business owner and family members, who start the small enterprise not out of a sense of entrepreneurship but because of a lack of alternatives (termed 'survivalist MSMEs' or 'entrepreneurs of necessity'). Many MSMEs are reluctant to seek formal sector credit because they consider the process complicated and overly bureaucratic, especially given that many fail to meet the documentation and collateral requirements. Therefore, they continue to depend on informal credit, despite high interest rates, owing to its easy and timely availability and flexibility in repayment (EEC-Nepal, 2009).

These businesses indicate their need for credit, but often do not have the technical skills, ideas or capacity to grow the business to enable them to repay the structured debt incurred from banks. Instead, they opt for loans, mostly from cooperatives and MFIs, which are easily available with less stringent documentation and collateral requirements. As the ownership and management of such businesses are usually not separated, the loans are at times channelled towards a different purpose from purely business purposes, which often drives such businesses into over-indebtedness.

It was observed that most of the MSMEs borrow from more than two institutions, and leverage on the borrowed sum to borrow larger sums or to manage their finances, thereby driving these types of businesses into over-indebtedness from multiple borrowings.

Use of credit as agriculture finance by farmers. Of Nepali adults, about 77% are involved either solely in farming or a combination of farming and other work (FinScope, 2014). While for most farmers (75% of this target market segment) this is primarily subsistence farming, 25% are trading farmers. The irregular nature of farming incomes and the high initial capital investment required in terms of seeds, fertiliser, livestock and/or farming equipment mean that many farmers require credit upfront.

FinScope shows that 52% of farmers take up credit, with about 36% of them borrowing from informal channels. The comparatively low uptake from formal channel (approximately 20%), despite government and donor-supported programmes making subsidised loans available for the agricultural sector, highlights that informal channels are still preferred by this segment, likely due to ease of administration and timely availability of such loans.

Of the total credit uptake by farmers, only 7% is used for buying farming equipment and for farming expenses such as seeds or fertiliser; 35% is used for consumption smoothing and emergencies.

Despite being a target market with a significant need for credit, farmers remain underserved, with 48% being excluded from access to credit services/products, especially in the more remote areas where they are left with limited choices between credit providers and products.

What products are available and in use?

Credit products in Nepal can be grouped into six distinct categories based on their intended use. These categories of loans are: business loans; personal loans; hire purchase loans; margin lending loans; real estate and personal housing loans; and deprived sector loans.

Table 14 provides a snapshot of loan products and their contribution to the loan portfolios of commercial banks, development banks and finance companies (classes A, B and C institutions, respectively).

	class A		class B		class C		Total	% of total credit portfolio
Business loan	588,049.75	65%	81,793.60	51%	23,407.89	36%	693,251.26	61%
Personal loan	94,997.38	11%	22,832.03	14%	12,493.87	19%	219,808.15	19%
Hire purchase loan	41,023.45	5%	15,906.14	10%	6,724.31	10%	63,653.90	6%
Margin lending loan	11,988.14	1%	4,112.98	3%	3,930.51	6%	20,031.63	2%
Real estate loan	125,140.96	14%	29,594.16	18%	17,231.90	26%	82,482.16	7%
Deprived sector loan	40,962.32	5%	7,564.63	5%	2,049.60	3%	50,576.56	5%
	902,162.00	**100%**	**161,803.54**	**100%**	**65,838.08**	**100%**	**1,129,803.66**	**100%**

Table 14: Product-wise loan detail (in NPR millions)
Source: Nepal Rastra Bank (2014/15).

The following sub-sections consider these credit product categories individually, including product features and uptake of each.

Business loan

Business loans are the largest product of the credit portfolio. Of total lending, business lending represents 61% of the formal credit portfolio.

No clear distinction is made between a corporate loan and an MSME loan. MSMEs that meet the requirements are eligible for a business loan. For the most part, what distinguishes an MSME loan from other business loans would be the smaller size of the loan.

Business loans mainly comprise term loans, overdrafts, trust receipt loans/import loans, demand and other working capital loans, and bills purchased.

In the business loan context, 'term loan' means a long-term loan; such loans constitute 15.32% of the formal credit portfolio. The remaining business loans are short-term loans, comprising 46.04% of the formal credit portfolio.

Commercial banks are the largest business lenders (lending approximately 85% of total business loans). These banks also provide the largest loans, at low interest rates (around 8% per annum).

Personal loan

Majority of the loans extended to individuals are in the form of personal loans. Of total lending, personal loans represent 19% of the formal credit portfolio. It is worth noting once again that for the majority of the population, formal loans are not an option, and informal credit is used.

Formal personal loans comprise products such as credit card, small and medium industrial loans, loan against deposit and bullion, personal borrowing against a mortgage, other miscellaneous loans, and loans provided by SACCOs.

Personal loans are extended to individuals for no specific predetermined purpose i.e. the individual accessing the loan can use the funds for any purpose for which they deem fit. Therefore, personal loans may be used for a variety of reasons, most commonly for consumption smoothing, but also for medical expenses, purchase of big-ticket household items, to fund education, for business or farming credit, to mitigate risk, to

	Commercial banks	Development banks	Finance companies
Provide business loans	✔	✔	✔
Authorised by central bank to provide trust receipt/import loans	✘	✔	✔
Authorised by central bank to provide overdraft facilities	✔	✔	✘

Table 15: Types of banks and their services

finance a house purchase, to finance foreign employment or to cover special social events.

SACCO loans are secured against members' savings. The maximum loan size from SACCOs typically ranges from NPR 100,000–200,000 (US$ 1,042–2,030) without collateral to NPR 500,000–600,000 (US$ 5,075–US$ 6,090) with collateral. The loans without collateral are secured by members' saving and a personal guarantee by a few other members. These SACCOs charge interest of 18%–25% per annum. Loans usually have a term of up to 24 months.

Adults with regular income can access personal loans without collateral from formal providers. The commercial banks, development banks and finance companies offer unsecured loans of an average duration of three years and average value of NPR 1.5 million (US$ 15,000) to those who can furnish the required proof of formal employment with regular income. The interest rate charged on these loans ranges from 12%–18% per annum on average. BFIs usually quote a higher interest rate for such loans, as there is relatively higher risk due to the collateral-free nature of the loan. The qualitative research suggests that because collateral is not required and the processing time is short, the uptake of such loans is very popular among those with regular income.

Proof of employment, pay slip and tax clearance are explicitly required in order to access personal loans from all formal financial institutions. Applicants also require a bank account and must comply with full KYC requirements, including an ID and proof of address.

Formal personal loans are therefore restricted to civil servants and the formally employed, who are generally much better served. As a result, all the other target market segments are restricted to informal sectors for personal loans.

Informal credit for savings group members. Those who belong to informal savings groups can access credit almost equivalent to the total deposit of the savings group (MAP Mystery Shopping, 2016).

Informal loans charged at a premium. All informal loans would be classified as personal loans, no matter the purpose of the borrower in taking out the loan. The majority of informal loans are charged in excess of 20% interest per annum on average, although these can vary substantially in individual cases.

Informal, personal loans are generally short term in nature. They can be taken from relatives and friends, although this is not very common; they are more likely to be taken by savings group members by virtue of their group membership, or from moneylenders (who are unregulated) or merchants.

Hire purchase loan

Hire purchase loans important for productive sector. Of the total lending portfolio, hire purchase loans account for around 6%.

Hire purchase loan are loans taken for the purpose of buying vehicles, machinery, tools, equipment etc. in instalments. Under a hire purchase agreement, ownership gets transferred once all the instalments have been paid by the borrower. Such loans have been considered profitable in retail lending and are being provided by all BFIs.

Generally, hire purchase loan durations range from 5–10 years. BFIs provide hire purchase loans up to 80% of the value and since the asset purchased (vehicle, machinery, equipment etc.) can be used as collateral, such loans enable MSMEs and farmers to automate and to adopt new technologies. Transportation is another sector that has benefited from this facility.

Margin lending loan

Margin lending encourages wider participation in financial markets. Of the total lending portfolio, margin lending loans account for approximately 2%. Their popularity is growing.

Margin lending loans are provided against the shares of the companies that are listed on NEPSE. Any individual, company or firm can take this loan against the shares owned by any person or company. This type of loan is a short-term loan, with interest ranging from 12%–14% per annum. All BFIs provide this type of loan.

Margin lending loans are becoming popular because banks are promoting this product due to excessive liquidity in the banking system, which creates a bullish trend in the stock market. This is a result of increased trading on the part of a larger population with increased purchasing capacity from availability of funds. Banks provide margin lending loans to the borrower on the assessment of the risk of the shares of companies listed with NEPSE held/purchased by the borrower, and finance up to 70% on a yearly revolving basis with the shares or purchase receipt as collateral.

Real estate loan and personal housing loan

Urbanisation, remittance flows driving demand for real estate credit. Of the total lending portfolio, real estate loans account for around 7%.

Real estate refers to immovable property such as land, land and a house, or any type of building or infrastructure used for residential, business or other purposes. Rapid urbanisation, combined with the general speculative assumption that the price of real estate will never decline and is the safest sector to invest in, as well as a lack of alternative investment opportunity in the country, have played an instrumental role in increasing real estate prices. In the past few years, with the country receiving high remittance inflows, the real estate sector has seen a surge in demand, mainly in the urban areas; and real estate is a key sector in which the banks have promoted lending.

An unwarranted credit surge to the real estate sector has generated asset price bubbles, which could lead to financial fragility and financial crisis. NRB has accordingly issued a number of directives to reduce the credit flows to this sector and minimise the risk profiles of the banking sector, attempting to pre-empt a situation of domestic financial crisis that could arise from increased credit flows to the sector despite a sluggish overall economic situation (Anon., 2011).

BOX 11. BRIEF OVERVIEW OF DEPRIVED SECTOR LENDING THROUGH MFIS, AND IMPLICATIONS THEREOF

In Nepal, MFIs are the primary providers of deprived sector loans, which are seen as potential game-changers in the realm of financial inclusion and increasing access to credit. The deprived sector credit policy under NRB has been instituted as a directed credit policy to promote access to credit for economically weaker sections of society, with commercial banks, development banks, and finance companies required to provide 5%, 4.5%, and 4%, respectively, of their total loan outstanding to deprived sector lending, either directly or indirectly.

While in recent years there has been a phenomenal rise in the supply of deprived sector credit due to policies, it is important to analyse how well the increase in credit supply has translated into expansion in credit access among the deprived.

Certain indicators relating to financial inclusion – such as the number of borrowers and MFIs – have risen significantly in the past few years. According to NRB, as of 2009 there were around 547,000 group members and around 436,000 borrowers enrolled in micro-credit development banks, while deprived sector credit is being provided by commercial banks and financial institutions – both directly and indirectly through NGOs or cooperatives. NRB's estimate suggests that around 400,000 poor have been given access to microcredit facilities ('Impact of Deprived Sector Credit Policy on Micro Financing', www.microfinancegateway.org/sites/default/files/mfg-en-paper-impact-of-deprived-sector-credit-policy-on-micro-financing-feb-2010.pdf). While these numbers underscore the importance of MFIs in the realm of deprived sector credit, certain concerns have been raised about their effectiveness and the implications of NRB's deprived sector lending policy.

Among formal MFIs, given their access to low-cost funds due to the provision of deprived sector lending, there has been a visible trend of high capital adequacy ratio and high liquidity, with investments and liquid funds making up almost 20% of assets in such institutions. The trend is even more pronounced for microfinance and regional rural development banks (RRDBs) and NGOs working in the financial sector promoting financial inclusion. Such high levels of liquidity are explained by the high number of loans, which form a significant portion – nearly 60% – of the liabilities for such institutions. High liquidity can arise when MFIs invest the loans acquired from commercial banks as an indirect mode of deprived sector lending into fixed deposits, where interest earnings are higher and thus the MFIs can earn profits. Among institutions like financial NGOs, which entrust the high levels of deprived sector lending funds that they receive to financial companies or banks instead of disbursing to clients directly, capital adequacy ratios rise. Since MFIs have lower risk weighted asset, the capital adequacy ratio is bound to be distorted (Ferrari, Jaffrin & Shrestha, 2006).

MFIs increasingly tend to park significant funds with other formal channels instead of disbursing loans to the deprived sector. Lending in the peri-urban areas is higher than in the rural areas, showing an inclination towards making a profit. This undermines the role of MFIs as it is envisaged in government's deprived sector lending mechanism.

All categories of BFIs, the EPF and SACCOs provide real estate loans. All the banks and financial institutions licensed by NRB are permitted to lend in the real estate sector within a specified limit (issued to regulate the lending). In addition, the EPF provides housing loans to its members. SACCOs are also among the financing agents of the real estate sector, especially for personal housing loans.

Finance companies have higher exposure in real estate sector. With regard to real estate and personal housing lending as a share of their total lending, finance companies have the highest exposure (26%), compared to development banks (18%) and finance companies (14%).

Deprived sector loan

MFIs are the primary providers for deprived sector loans. Of the total lending portfolio, deprived sector lending accounts for 5%.

Deprived sector loans are small loans that are provided to poor people based in rural areas. Deprived sector lending is a mandatory credit policy of NRB, and these loans are among the central bank's measures to promote financial inclusion and establish the habit of formal banking in the rural and poor areas. Under this policy, commercial banks, development banks and finance companies are required to provide at least 5%, 4.5% and 4%, respectively, of their total credit portfolio to this sector, either directly or indirectly. The indirect way of lending to the deprived sector is through wholesale loans to class D MFIs established for the purpose of providing credit to small farmer cooperative societies and institutions conducting micro-credit activities. The lending in this sector is meeting the regulatory requirement, and the majority of the lending is being done through MFIs. Generally, these loans are provided to group members for a short duration of time.

Loan size and interest rates. All the MFIs offer group loan products, which constitute the vast majority of their clients. As per the regulation, the group members that have been using deprived sector lending from MFIs for the past two years and are categorised as good borrowers will be entitled to borrow up to NRP 300,000 (US$ 3,045), and collateral-based micro-enterprises will be entitled to borrow up to NPR 700,000 (US$ 7,104).

Only a small portion of loans extended by MFIs and banks are to start-ups, with most institutions unwilling to give credit to businesses that do not have a track record.

The official NPL ratio reported by MFIs remained at 1.2% (Bank, 2014) during FY 2013/14. The low NPL can be attributed to improved internal controls, better portfolio management

and growth as a result of stricter regulatory requirements to receive institutional wholesale funds (Micro-Credit Ratings International Limited, 2012). However, multiple lending, and concentration and competition of MFIs leading to loans being refinanced, have been highlighted as among the issues of concern during the MAP qualitative interviews and focus-groups discussions. Therefore, the NPL figure is mostly likely significantly understated.

Who are the providers?

Large number of formal providers yet access to finance low. Despite the large number of formal credit providers (32,902), the credit market is still underdeveloped. From the credit access strand (already discussed), it is evident that the reach of formal credit providers is very low – almost non-existent for low-income people living in the rural areas and away from the key market centres. Despite exponential and diverse growth in the financial sector over the past two decades, access to finance in most of the districts in the mid- and far western parts of the country is very limited and a sizeable number of people are either unbanked or under-banked. MFIs and SACCOs have been able to serve the unserved – but in the more remote areas, formal financial credit services are still beyond the reach of many.

Informal providers are the largest credit providers. Table 16 shows the different financial service providers' customer groups by target market segment. Despite the fact that the country has a huge number of banks and other formal financial institutions, it can be seen that informal providers are the largest financial service providers in terms of number of clients. This reflects challenges on the part of consumers in accessing formal financial services.

It can also be seen that farmers, who constitute 32% of the adult population, are the largest population on informal providers' client lists; despite farmers being the largest target market segment, their access to credit – especially formal credit – is very limited.

Banks provide largest amount of credit, informal provide highest number of loans. Figure 39 shows that, in terms of client numbers, the overall credit market is dominated by informal providers. More than 21% of the adult population – 60% of total credit users – access credit from informal sources.

Of formal credit users, banks have the greatest share, with 22% of total credit clients. MFIs and SACCOs each account for 21% of total credit clients.

When it comes to the total loan book, banks completely dominate, accounting for 66% of total credit. However, this includes credit extended to corporates and individuals alike, as well as deprived sector lending.

Therefore, banks play a central role in the credit market in Nepal as the largest providers by value, but only play a peripheral role in the provision of credit to individuals. The other formal providers account for 34% of the total credit market, of which 14% of the value of total loans is extended through cooperatives, which are loosely regulated.

Informal providers the credit provider most used by low-income adults. Figure 72 indicates that not only is the informal sector the largest provider in terms of number of clients, but it also serves a low-income market that would otherwise not have been served. The average monthly income of adults accessing credit from moneylenders is NPR 5,745 (US$ 58). By contrast, the average monthly income of adults accessing credit from banks is NPR 11,190 (US$ 114) and from cooperatives is NPR 9,242 (US$ 94). Thus, although moneylenders are unregulated, they play a key role in extending financial services to many low-income adults.

Growth in credit provision by commercial banks. Loans and advances by commercial banks increased by 19.5% to NPR 877.72 billion (US$ 8.9 billion) as of July 2014, compared to a total of NPR 734.20 billion (US$ 7.45 billion) in the previous year. For public and private sector banks, the growth in loans and advances was very similar – i.e. 19.8% and 19.5%, respectively.

	Bank	Other formal	Informal	Family and friends	Excluded
Salaried workers	263,962	231,929	318,058	155,003	263,962
MSMEs	293,550	319,708	421,016	131,424	293,550
Remittance receivers	122,866	113,420	500,723	134,792	122,866
Farmers	488,140	467,346	1,659,028	321,892	488,140
Irregular earners	120,162	152,288	857,600	232,770	120,162
Dependants	220,572	122,880	434,080	121,925	220,572
Total	**1,591,149**	**1,515,732**	**4,443,427**	**1,180,147**	**8,212,182**

Table 16: Number of clients, by type of provider and by target market segment

Source: FinScope, 2014.

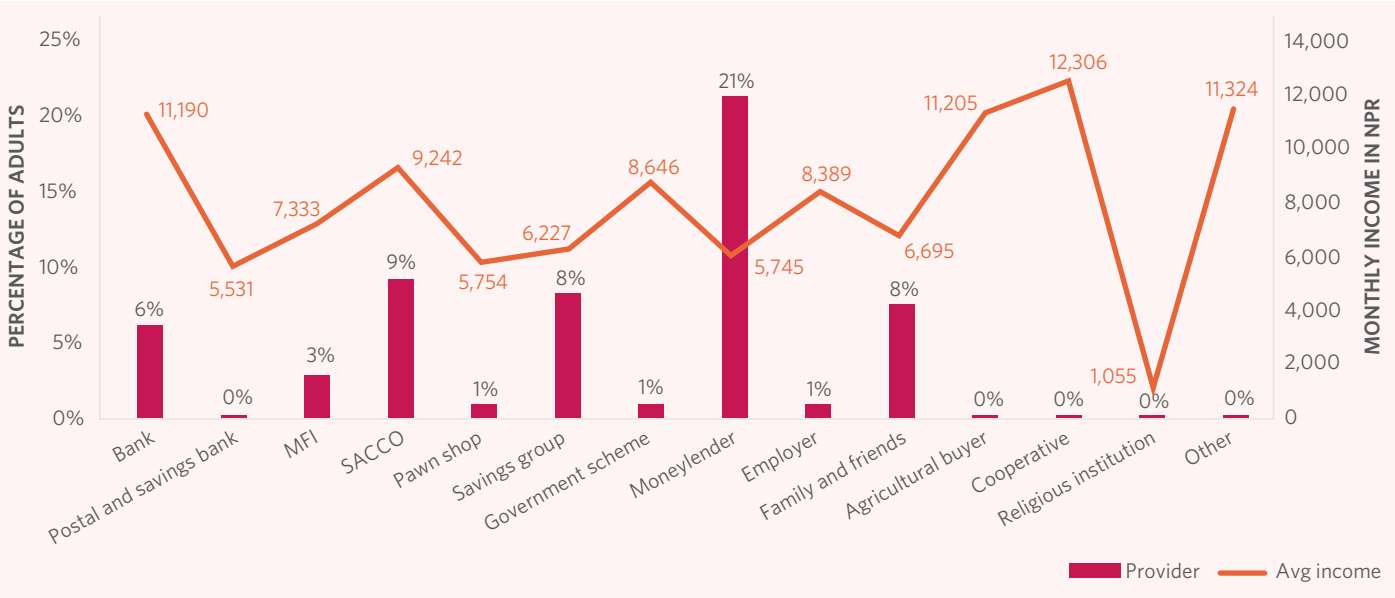
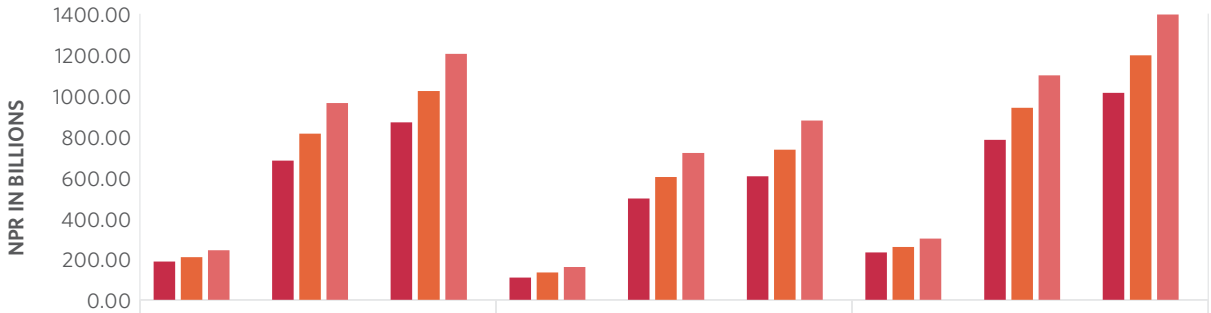


Figure 39: Overview of credit providers

Source: FinScope, 2014.



	DEPOSITS			LOANS AND ADVANCES			TOTAL ASSETS		
	Public	Private	Total	Public	Private	Total	Public	Private	Total
2012	187.07	680.84	867.90	107.51	495.54	603.06	230.57	782.19	1,012.76
2013	208.48	812.31	1,020.79	133.22	600.97	734.20	257.47	939.49	1,196.95
2014	242.44	961.78	1,204.21	159.56	718.16	877.72	298.11	1,098.38	1,396.49
Change 2014-2013	16.3%	18.4%	18.0%	19.8%	19.5%	19.5%	15.8%	16.9%	16.7%

Figure 40: Commercial banks – details (at mid-July 2014)

Source: Nepal Rastra Bank, 2014 (Bank Supervision Report).

Similarly, the total assets of the commercial banks increased by 16.7% to NPR 1,396.49 billion (US$ 14.17 billion) compared to NPR 1,196.95 billion (US$ 12.15 billion) in the previous year. Total assets grew by 15.8% in public banks, and by 16.9 % in private banks. Figure 40 shows growth of deposits, loans and advances, and total assets on the part of commercial banks.

Bank loans and advances backed by security. Almost all of the loans and advances disbursed by the commercial banks are found to be secured by securities. At mid-July 2014, 81.34% of the total loans and advances were secured by property as collateral. Similarly, 3% of the total loans and advances were secured by gold and silver and 9.47% by other securities. The regulatory requirement that prevents commercial banks, development banks and finance companies from providing non-collateralised loans above NPR 1.5 million has hindered their ability to tap into the low-income group and/or rural markets. Also, MFIs and SACCOs provide loans without collateral for amounts less than NPR 300,000.

Commercial banks' credit extension targeted predominantly at commercial customers. Other than consumption loans (at 7.6% of their total loan book) and deprived sector credit (at 6% of their total loan book), the product offerings of commercial banks are largely targeted at commercial customers, who own sufficient collateral to access loans and are easy to reach because they are typically located in urban areas; the manufacturing sector is the dominant sector of lending (with a 22.96% share of the total loan portfolio), followed by wholesalers and retailers at 22.80%, and construction at 9.86%.

Non-performing loans are minimal. The non-performing loans (NPLs) of commercial banks stood at 2.92% of the outstanding

BOX 12. RURAL SELF RELIANCE FUND (RSRF) CREDIT PROGRAMME

The Government of Nepal and NRB established the RSRF in February 1991, with the objective of raising the economic status of low-income communities in the rural areas through financial support to aspiring entrepreneurs looking to engage in income-generating activities.

RSRF acts as a wholesale lender to savings groups, cooperatives, and NGOs functioning as financial intermediaries; while long-term loan provision is available from microfinance companies and Agriculture Development Bank Ltd. Apart from this, RSRF conducts programmes and activities for the upliftment of the economic and social levels of rural households and individuals, and aids cooperatives and NGOs in building self-capacity to disburse loan facilities to eligible groups (Nepal Rastra Bank, 2015).

The RSRF operational directive outlines various details relating to the target group, loan criteria, selection and disbursement procedure for various stakeholders, and a structural framework. For instance, RSRF recognises its target group to range from individuals to households unable to meet minimum annual consumption required for their family members from their family income, or those who earn below the minimum wage, who do not have any outstanding loans with any financial institutions, and those who have been identified by the Government of Nepal as poor and deprived (Nepal Rastra Bank, 2013). Similarly, cooperatives and NGOs can receive up to 20 times their core capital or up to NPR 2.5 million (US$ 25,354) in their first borrowing. After the first borrowing has been repaid in its entirety, the cooperatives and NGOs can receive 15 times their core capital or up to NPR 3 million (US$ 30,425) on the second borrowing; on the third borrowing, the credit line can be up to 15 times their core capital or NPR 3.5 million (US$ 35,496) (Republica, *2013).*

RSRF is chaired by the deputy governor of NRB, with three committee members i.e. joint secretaries of Ministry of Finance, Ministry of Federal Affairs and Local Development, and Ministry of Cooperatives and Poverty Alleviation, and a member-secretary (i.e. the executive director of NRB, micro finance promotion and supervision department).

Over the period of more than two decades, the Government of Nepal and NRB jointly have allocated increasing amounts into RSRF, initially from NPR 10 million (US$ 202,840) in FY 1990/91. As of FY 2014/15, the total capital of RSRF amounted to NPR 793.4 million (US$ 8,046,653). So far, RSRF has covered 68 out of 75 districts, partnered with over 1,000 organisations, disbursed NPR 1.66 trillion (US$ 16.8 million) in loans with NPR 572.8 million (US$ 5.8 million) currently being invested, and catered for 48,679 households. Its NPL rate is 5.45% (Nepal Rastra Bank, 2015).

loan, equivalent to NPR 26.31 billion (US$ 267 million). Development banks had NPLs of NPR 6.8 billion (US$ 69.01 million), equivalent to 4.2% of the total outstanding loan. As banks are reliant on collateral-based lending, this has also contributed to maintaining a low level of NPLs. Given these low levels, banks are in a comfortable position to lend.

Mandatory requirement for deprived sector lending. As already mentioned, with the objective of enabling the poor to access credit for self-employment purposes, as a poverty alleviation strategy, NRB has made it mandatory for BFIs to channel a certain percentage of their total lending to the deprived sector. Commercial banks, development banks and finance companies are to this end required to lend 4.5%, 4% and 3.5%, respectively. As of mid-July 2014, BFIs' total lending to the deprived sector had increased by 30.4% to NPR 52.8 billion (US$ 535.877 million). The overall deprived sector lending by BFIs as of mid-July 2014 was 5.1%, where commercial banks, development banks and finance companies had lent 5.2%, 5.4% and 3.5%, respectively. That is to say, BFI lending to this sector is above the minimum regulatory requirement. Banks and financial institutions are meeting this requirement through wholesale lending to MFIs or through establishing their own MFI subsidiaries.

MFIs charging high interest rates. There is a general perception that lending rates of institutions providing microfinance services are high. Some of the low-income borrowers have trouble borrowing at such a high rate. The MAP qualitative research (2015) found that the MFIs charge interest from 18%–36% per annum. Though the MFIs were set up with a social mandate of increasing financial inclusion, there is an increasing move towards commercialisation. This trend may have a negative impact on the overall stability of the financial system and could undermine the notion of the importance of increasing access to finance to those who are unbanked.

What are the barriers to usage of credit services and products?

Access barriers include proximity, eligibility, affordability and appropriateness barriers. Usage barriers include financial capability, trust and inconvenience/hassle barriers.

Access barriers

Lack of documentation and collateral major barriers for access to credit. FinScope (2014) data shows that 24% of Nepali adults who were refused a loan, were refused on the basis of lack of proof of sufficient income.

The MAP qualitative study has also shown that adults involved in entrepreneurial ventures are unable to get funding as they do not have collateral, credibility or proof of stable income. This is also validated by the FinScope (2014) data, which shows that 19% of adults who were refused a loan could not provide collateral, while 16% could not provide the required down payments. Nepal's credit market is driven by collateral, and the lack of

assets that meet the collateral requirement make it difficult for the poor to access credit.

Recording of three generations' credit history impacting on borrowers' eligibility. The Credit Information Bureau records the borrower's personal information, which includes the name, citizenship number and information of three generations. The credit history of the family influences the credit rating of the individual, meaning that a default on repayment on the part of an individual's grandparent/parent can impact negatively on the individual's credibility.

However, in Nepal there is general social acceptance for defaulting on loan repayment, and as a result no social pressure

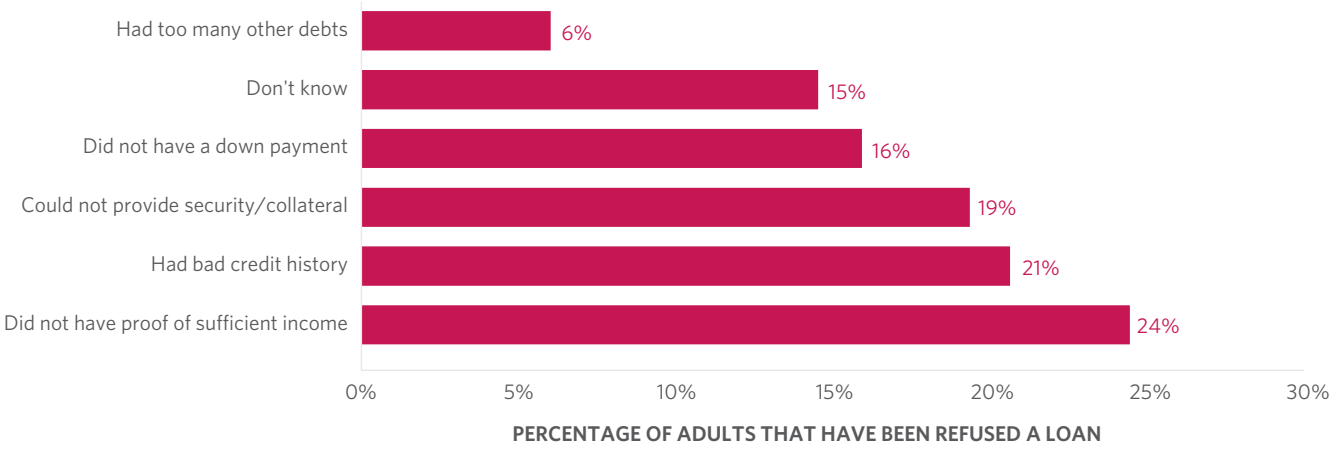


Figure 41: Reasons for being refused a loan
Source: FinScope, 2014.

BOX 13. YOUTH AND SMALL ENTREPRENEUR SELF EMPLOYMENT FUND (YSESEF)

Established by the Government of Nepal in 2008, YSESEF is a self-employment scheme that aids in the provision of collateral-free loans from partner banks, cooperatives and financial institutions at low interest rates for unemployed youths and would-be small entrepreneurs to be self-employed. This initiative has been undertaken with the prime objective of assisting in the improvement of livelihoods of marginalised and disadvantaged households by enhancing their income generation through financial support for self-employment (Ministry of Finance, 2014/15).

YSESEF is guided by the Youth and Small Entrepreneur Self Employment Fund (Operations) Rules 2008, laying out details about its activities, and credit disbursements, among others. For instance, to identify youths with potential, orientation sessions are held at the district level by YSESEF partner institutions, where necessary information about the fund, and its loan acquirement and repayment procedures, among others things, are provided along with capacity-building and skills development trainings. Likewise, in order to be eligible for YSESEF credit, the individual has to be unemployed and within the age group of 18–50.

In general, credit facilities are provided to entrepreneurs whose area of work falls under commercial farming, agro-based industry or service-oriented industry. Priority is given to projects that make use of local raw materials and skills development, projects that emphasise consumption in the same village as the production, projects on 'one village, one product', and the projects run by conflict victims, people living with disabilities, members of injured and martyrs' families, oppressed, indigenous nationalities, Dalits and women.

The credit itself is essentially provided by the partner banks, cooperatives and financial institutions affiliated with YSESEF for up to NPR 200,000 (US$ 2,028) for individuals and NPR 5,000,000 (US$ 50,710) for groups; where YSESEF provides loans to these institutions at an annual rate of 6%–7% while the bank and financial institutions concerned issue it at 12%.

Regarding YSESEF's source, the funds are contributed by commercial banks, development banks and finance companies as part of the mandatory deprived sector lending. YSESEF also has provisions for mandatory insurance through Rastriya Beema Sansthan, where YSESEF is liable to pay the insurance premium.

Recently, YSESEF has generated over 25,000 self-employment opportunities in 73 districts. As of 2014, YSESEF had made investment of NPR 2.5 billion (US$ 25.3 million) (The World Bank (c), 2014).

to ensure loan repayment. In such a scenario, it becomes difficult for the young generation to secure fresh credit. The law does not restrict one from borrowing if one is not the principal borrower, but every borrower is required to provide the credit history of three generations and if one of them has defaulted it has an impact on the other.

Usage barriers

Limited need the main reason for not taking up credit. As shown in Figure 42, of those adults without credit, 38% (23% of total adults) do not require credit to pay their daily living expenses, and 35% (21% of total adults) have no specific reason for borrowing. This is indicative of a limited use case for credit on the part of the adult population. There is a need to enhance the ability of individuals to make use of credit for productive purposes.

Lack of customised products discouraging uptake. Nepali banks offer a homogeneous and generic range of products, where the missing middle segment of the population is unable to access credit. Despite the high number of BFIs in the country, accessibility and inclusiveness remain low. Lack of customised products has led to failure to meet consumer needs. There is a need to match the demand and supply of credit products in the country, and products catering to specific target market segments need to be delivered through the appropriate channels. There are no official restrictions from the regulator with regard to introducing different credit products (Nepal Rastra bank, July 2014).

"Before the Dashain festival I need to stock up my merchandise so I need credit for 1–2 months, but MFIs deny my request as the loan amount is large. But if I go to banks they will recommend me to take out a larger loan, which I don't need. So I take loans from moneylenders who charge as high as 120%." (MSME owner, male, aged 32)

Long and costly loan procedure. The current delivery method of loans is costly and unfavourable, especially for short-term loans. The process of accessing loan starts with an application, which then moves to processing, followed by approval and then closing. A pre-qualification procedure provides the borrower with an estimate of how much money can be borrowed and the down payment amount that needs to be paid. The submission of a completed application is followed by the verification of the borrower's information. Buildings and other assets used as collateral need to be insured. On average, an individual loan approval process can take up to two weeks. As banks are not in close proximity to customers outside the urban areas, the long loan approval process acts as a further barrier to accessing credit from formal channels. The onerous administrative process that banks impose, coupled with processing fees up to 1.5% of the value of the loan, greatly reduces the accessibility of credit for adults.

Strong competition among BFIs undermines credit discipline. Due to the large number of BFIs, it is becoming difficult to track either multiple borrowings or customer loyalty. Although the existence of competition improves credit availability, this has on the flip side resulted in customers frequently changing banks with increased overlapping and duplication. Moreover, Nepal has a strong 'people culture' in terms of which clients are loyal to particular staff members rather than to the bank. Thus, when a relationship manager or a bank staff member switches banks, they tend to take a large portion of their client base along with them.

What regulatory and policy issues need to be considered?

Monitor the implementation of mandatory deprived sector lending by banks. The regulatory requirement for banks to provide deprived sector lending has resulted in banks either opting for wholesale lending to MFIs or establishing their own MFI subsidiaries. The banks should be providing retail deprived sector lending, such that lower-value loans are available at bank rates (which are generally lower than the rates charged by MFIs). Currently, deprived sector lending is taken up mostly as a tick-off activity for banks.

Monitoring of MFIs and SACCOs should be prioritised. Currently, MFIs are only required to submit a six-monthly report, as a

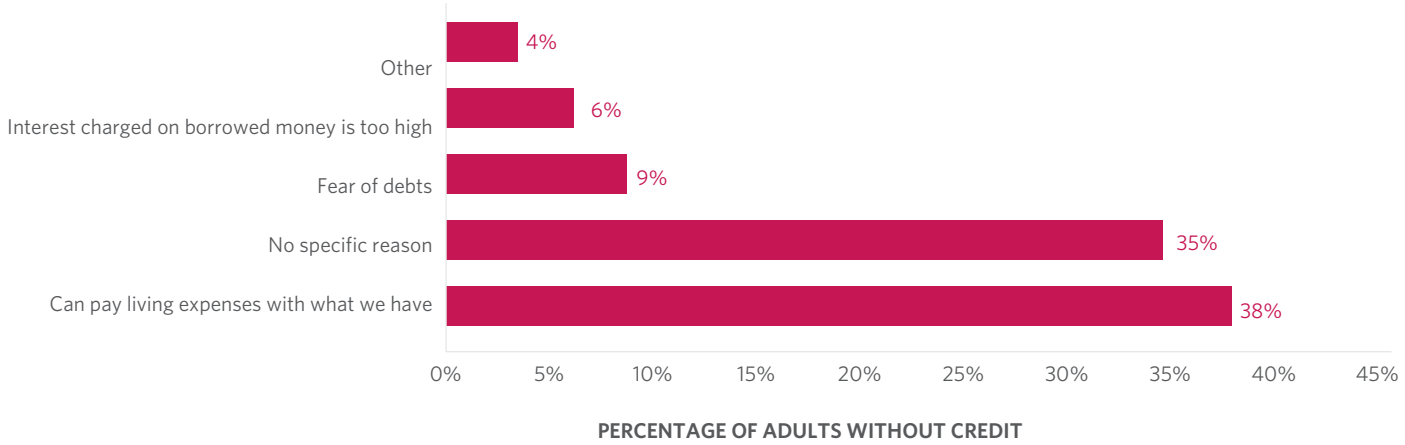


Figure 42: Reasons for not borrowing
Source: FinScope, 2014.

form of monitoring, which is overseen by NRB's Micro Finance Promotion and Supervision Department. The central bank's field inspection generally covers class A and B banks. Given the high number of MFIs and SACCOs, should these institutions fail it would have a direct, negative impact on the poorest segments of society, which makes it crucial that these institutions be monitored effectively and on an ongoing basis.

Expedite the implementation of secured transaction registry. NRB is implementing a project that focuses on the implementation of a secured transaction registry. This central database will contain the details of all claims made on assets of a particular corporate or individual debtor. The implementation of the Secured Transactions Act (2006) will ensure the elimination of multiple borrowing and also open up the provision of loans against the collateral of movable assets. The Act requires movable assets to be registered with the registry office, while putting the asset as collateral in a BFI. The implementation of this Act will allow movable assets such as gold, silver, grain and cattle to be put up as collateral. The delayed operation of the registry is barring the target market from accessing credit against movable assets, and thus the implementation and operation of the registry should be prioritised.

Ensure implementation of directive mandating MFIs to access the Credit Information Bureau. NRB's regulation mandates that all BFIs registered with the central bank and engaged in credit lending of NPR 1,000,000 and above must be registered with the Credit Information Bureau (CIB). Only members will have access to credit reports and other credit information services. Currently there are 157 BFIs registered with the bureau (Credit Information Bureau, 2015). However, the commercial banks and development banks constitute the major portion of the member portfolio, with only four MFIs and cooperatives associated with the bureau. MFIs were recently mandated to become members of the CIB. Previously, MFIs were only mandated to share information about loans of more than NPR 50,000 with class A, B and C banks. The new directive requires MFIs, cooperatives and FINGOs to share information about the borrowers with outstanding loans of NPR 50,000 or higher.

Improve institutional governance and monitoring. There is a need to improve institutional, structural, legal and regulatory aspects of the system so as to bring more of the population into the formal banking channel. The increase in shadow banking activities promotes the usage of informal banking channels, yet the lack of proper monitoring mechanisms means that fraud goes either entirely undetected or undetected for too long.

BFIs need to adopt proper targeting, credit appraisal, credit risk mitigation and active monitoring as part of an effective risk management process. In particular, corporate governance/monitoring at the MFI and SACCO levels is weak; this is problematic as these are the providers to the low-income segments. It is imperative to build the capacity of these institutions so that they are able to grow and reach a larger group, with higher levels of customer service and protection.

What and where are the gaps and opportunities?

Educate consumers on credit already available to them. Consumers who hold a life insurance policy are able to access loans on the back of those products, yet many are not aware of this; loans can be accessed against one's life insurance policy at varying percentages of the surrender value depending on the company they are insured with (Insurance Board, 1993).

Introduce credit scoring-based lending. Nepal's credit market is heavily collateral based. In order to move towards a market with more non-collateralised credit, it is important to have a system where integral credit information – whether positive or negative – is captured. Furthermore, this needs to be supported by regulations. NRB currently has capped the provision for non-collateralised loans up to a maximum of NPR 1,500,000 – any amount higher than this needs to be collateralised and 5% of their total loan portfolio. If the functioning of the CIB can be expanded, it is more likely that individual credit-scoring based lending could be introduced.

Leverage micro-credit to establish credit usage habit. Given the low uptake of credit services, micro-credit through MFIs needs to be leveraged to increase financial awareness and also to inculcate banking habits among the wider population. NRB has introduced a provision whereby MFIs can access a loan of NPR 12 million at zero percent interest – on condition that they open and operate branches in 22 districts (Ministry of Finance, 2015). MFIs have a very strong client service culture and also offer financial literacy programmes, trainings and refresher courses. This can be an influential pulling factor for the unbanked sector to enter the formal banking channel.

Strengthen financial viability of microfinance sector. Nepal's microfinance sector has been servicing micro-entrepreneurs and the poorer segments of the population. Although, in the early stages, microfinance initiatives were driven by donor funding with the motive of alleviating poverty, the sector has now moved to a market-driven focus. However, the sustainability of the sector has been questioned, as the providers are still heavily reliant on the low-cost funding available from commercial banks under the deprived sector lending policy. Furthermore, MFIs often leverage donor grants to fund their activities. Given that MFIs are accepted as a step on the way to the uptake of formal banking services, they play a crucial role in increasing financial access. In this scenario, it is vital that MFIs operate in a sustainable manner. NRB needs to put in place regulatory and supervisory mechanisms that promote the sustainability of MFIs. There is thus a need for enforcing a regulation and supervision system, increasing the capacity of human resources and addressing the issue of multiple/duplicate borrowings.

Feed demand for value chain financing. Given that all the target markets are involved in farming as a primary or secondary source of income, the potential of value chain financing in Nepal is immense. Due to the lack of value chain financing, people are prevented from capturing potential markets. Value chain financing and warehousing/cold storage infrastructure are not available in rural areas, making it difficult for farmers to get

good value for their produce. The financial service needs of value chain actors vary, meaning that a coordinated effort would be required from BFIs to ensure that they meet the varying demands.

Introduce value-added service. Credit products need to be bundled with additional services so as to increase their uptake and ensure usage. The needs of the different target market segments must translate into credit products that meet those unique needs. For instance, warehouse receipt financing – which is a form of inventory financing where loans are made on the basis of goods held in trust as collateral – is an attractive value-added credit service for farmers. Similarly, life skills and enterprise skills training should be provided so that people in the different target market segments are able to make use of productive credit to uplift their living standards.

Focus in on trading farmers. Of the trading farmers, 24% (versus 18% of subsistence farmers) access formal credit: trading farmers have potential for future income streams from crop sales and thus could more readily support repayment of productive credit.

Adopt alternative delivery mechanisms. The cost of putting together a network of agents, sub-agents and representatives is high for BFIs. Moreover, the central bank has barred BFIs from charging fees other than the cost of the service (i.e. transaction fees). This makes it very difficult for BFIs to fund the expansion of their networks to far-flung areas. The government needs to leverage and consolidate the efforts of development partners working in the field of access to finance, to identify and test a reliable and cost-effective mechanism of delivering credit services.

The market for insurance

Summary

- Overall (formal/informal), insurance uptake stands at a low 20% of the adult population.
- Penetration of formal insurance is extremely low, with 89% excluded from the formal insurance market.
- Informal risk mitigation is prevalent to a certain degree through community support and friends and family.
- Insurable risk events are more commonly covered by credit than insurance.
- Current users of insurance are for the most part employed, male, urban and educated.
- When absolute numbers are considered, farmers emerge as the key group, followed by MSMEs and salaried workers.
- Illnesses and medical expenses are the most pronounced insurance needs.
- Life insurance, particularly endowment products, is the primary driver of the insurance industry in Nepal.
- There is a relatively broad range of entry-level products under the life insurance category.
- Mandatory insurance regulation is helping to improve insurance uptake: particularly third-party motor vehicle insurance, and credit-life insurance in MFIs.
- Distribution of insurance products is still heavily reliant on the agent-based model – individual as well as institutional.
- Barriers to insurance uptake include lack of awareness among consumers, lack of product affordability combined with consumers' irregular incomes, and consumers' inability to show required proof of income.
- Lack of a strong regulatory environment in the health industry inhibits health insurance provision.
- The stringent regulatory environment (the Insurance Board) is straitjacketing insurance companies in terms of innovation and product differentiation as well as maximisation on investment returns.

Context

Both qualitative and quantitative research indicates that individuals in Nepal face a number of costly risk events. There is evidence that Nepali adults either took on additional credit (68% of adults), used savings (48% of adults) or did nothing (38% of adults) to cover unforeseen expenses or cope with financial problems. This behaviour, especially in an environment with high inflation and low deposit interest, is not always the most appropriate way to prepare financially or to face risk events. At least 13% (21,480) of the population combat such drawbacks by saving in assets such as jewellery or livestock, rather than holding money at a financial institution (FinScope, 2014).

What insurance is used, and how?

Low insurance uptake. The overall uptake of insurance is relatively low when comparing it with the other product categories. Overall, insurance uptake stands at only about 20%: only 11% of adults in Nepal have formal insurance coverage; and 9% of adults have only informal insurance coverage (mainly in the form of some cushion against risk events that is provided by community groups).

When total informal insurance uptake is examined (taking into account overlaps with formal), 11% of adults access informal insurance services and products.

Meanwhile, a significant portion of the population (approximately 80% of adults) is totally excluded from the insurance market.

Insurance uptake may be underestimated. The MAP qualitative research (2015) indicates that the market has a proliferation of informal insurance products from India's insurance providers who, as a result of an enhanced market, are able to provide better returns. This is more evident along the 'fluid' border area between Nepal and India, particularly in the Terai region.

Furthermore, there is a high proliferation of mandatory and bundled products (discussed further below), which could lead to consumers being unaware of the fact they have obtained an insurance product and therefore under-reporting formal and informal uptake. Taking this into consideration, it is possible that insurance coverage figures may have been underestimated.

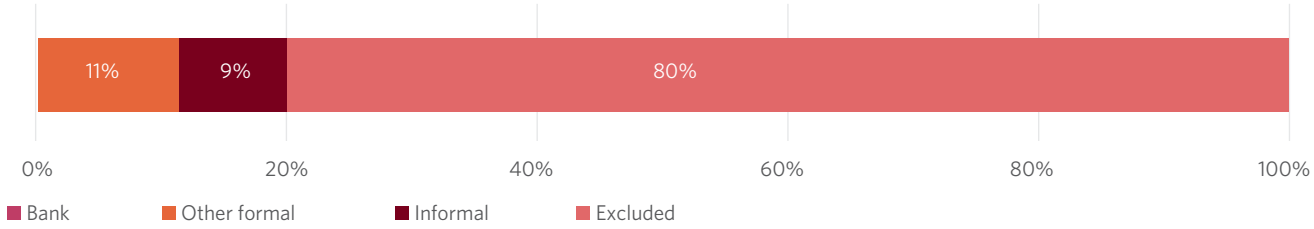


Figure 43: Insurance access strand

Source: FinScope, 2014.

Community support provides coping mechanism for major risks. Qualitative and quantitative research indicates that community support helps the adult population to deal with uncertain life events. These risk events generally stem from illnesses within households or are a result of natural calamities such as earthquakes or droughts. Figure 44 also emphasises this point, with 74% of adults citing family members as the first point of access when risk events occur. Only when these groups are unable to meet the needs do adults subscribe to other channels, with formal financial institutions generally a last resort (FinScope, 2014).

Few use insurance as a risk-mitigation mechanism. Figure 45 illustrates the risk-mitigation mechanisms used by adults that have experienced an insurable risk event in the previous 12 months. The most used mechanism is credit (28% of adults) and the least used mechanism is insurance (1% of adults). Low uptake of insurance (approximately 20% of adults) is the main driver of this low insurance usage figure.

However, the relatively high usage of the other risk-mitigation mechanisms indicates that there is scope for the insurance market to grow.

Life insurance driving the sector. The FinScope data indicates that life insurance (including credit-life) is the most popular insurance product:

- 44% of the insured population have life insurance; that is, 9% of the total adult population.
- Life insurance is also the most known product among the rest of the adult population.

The next most popular insurance product is motor vehicle insurance (13% of insured adults – 3% of the adult population).

Of the adult population, 74% were aware of life insurance as a product offering, followed by the next top products: accidental insurance (42%) and motor vehicle insurance (39%).

Better educated, male, and urban adults have greater usage of insurance. Figure 46 illustrates the uptake of insurance by various demographic classifications. Insurance uptake is higher for better educated adults. Of males, 24% have insurance, compared to 19% of females. Location also matters for insurance uptake: 32% of adults living in urban areas have some level of insurance; while only 19% of adults in rural areas have insurance cover.

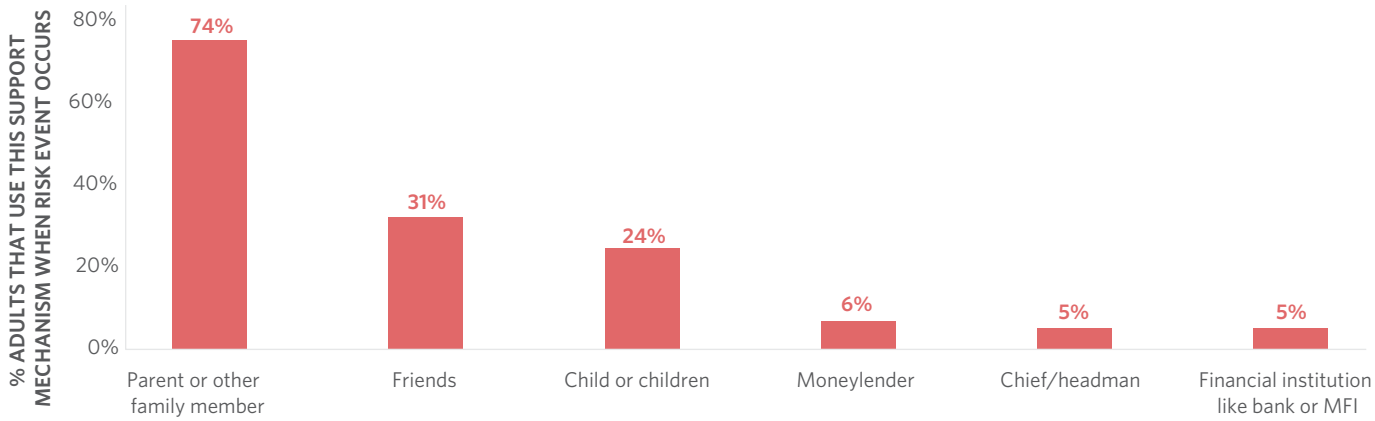


Figure 44: Points of access during risk events

Source: FinScope, 2014.

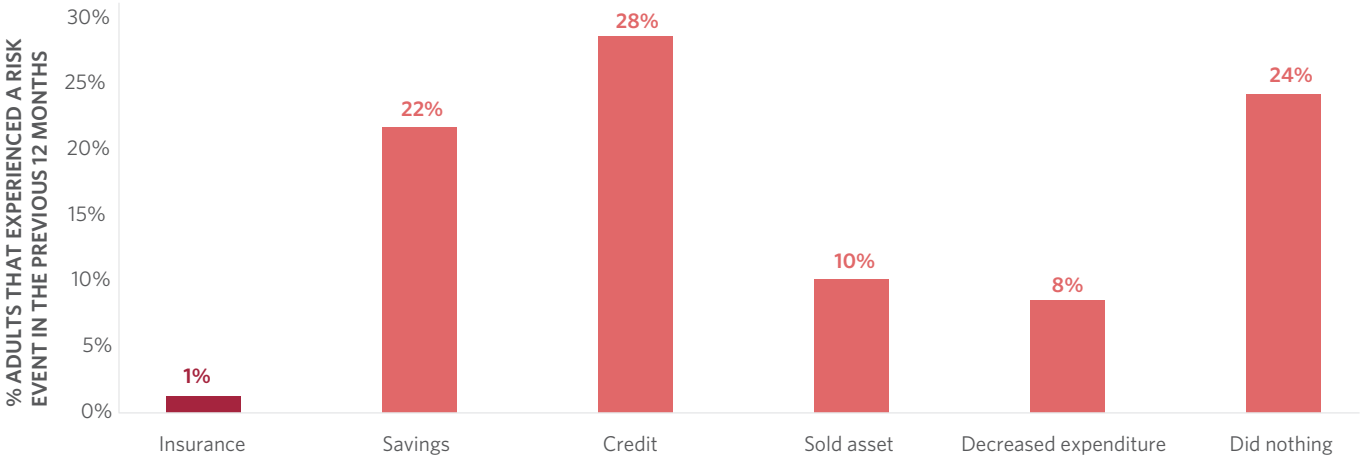


Figure 45: Risk-mitigation mechanisms used by adults that have experienced an insurable risk event in the previous 12 months

Source: FinScope, 2014.

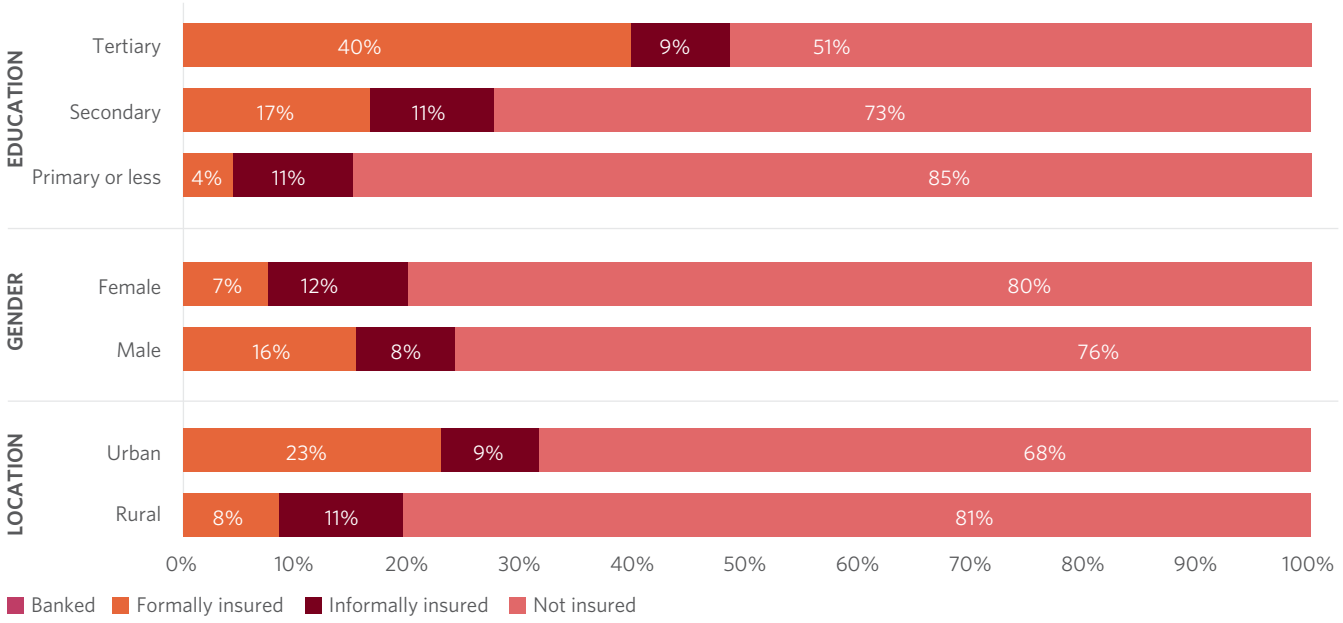


Figure 46: Insurance uptake by education level, gender and urban/rural
Source: FinScope, 2014.

Salaried workers best served of the target market segments. The uptake of insurance products is strongly correlated with the salaried workers target market segment: more male, more urban, and more educated. Of salaried workers, 36% report having insurance cover. A key reason is that coverage is often received through employers. The MAP qualitative study (2015) indicates that this is also due to tax incentives provided by the government: for individuals holding life insurance policies, with the rebate not exceeding NPR 25,000; and for women in the workforce, who get a tax rebate of 10%.

MSMEs are not far behind: 31% report having insurance cover.

However, the numbers decline to 21% of farmers, and only 12% (including overlaps) of irregular earners (see Figure 47).

In absolute-number terms, farmers are key. When absolute numbers are considered, farmers emerge as the key group (6% of adults), followed by MSMEs (4% of adults) and salaried workers (3% of adults).

It is worth noting that for the three highest-earning target market segments – viz. salaried workers, MSMEs and remittance receivers – this is driven by formal insurance; for the remaining three segments (lower-earning) – viz. irregular earners, farmers and dependants – this is driven by informal insurance.

How are insurance services and products currently being used?

This section outlines the use cases for insurance as identified through qualitative and quantitative demand-side research. This is done through examining insurable risk needs. While

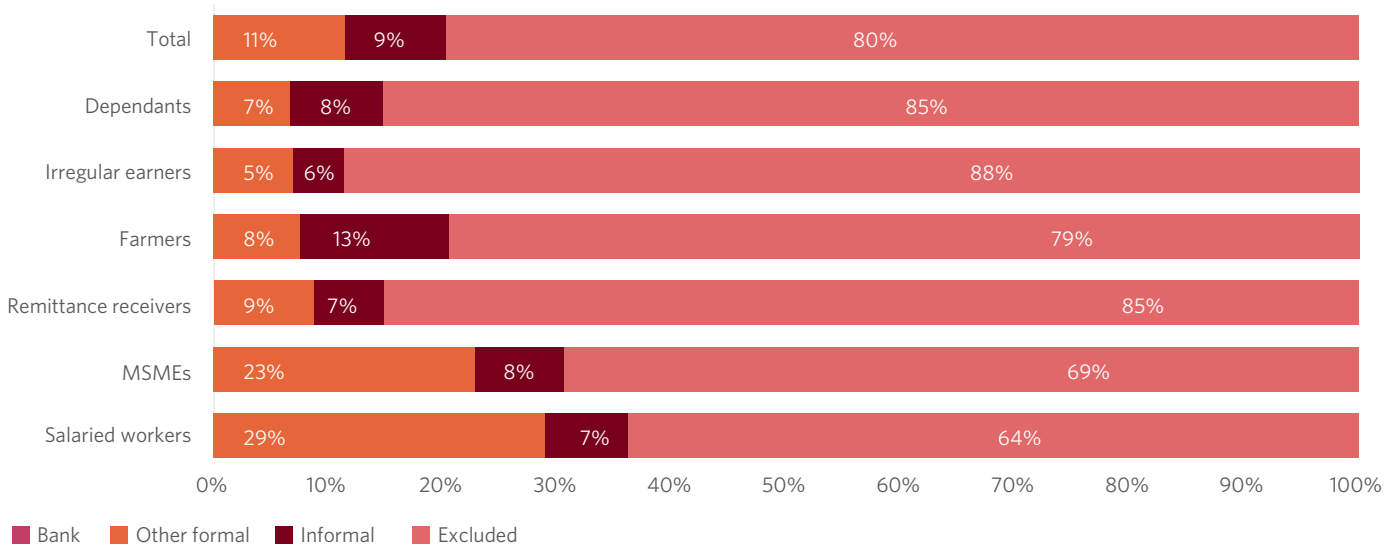


Figure 47: Demographics of insured versus Nepali adult population
Source: FinScope, 2014.

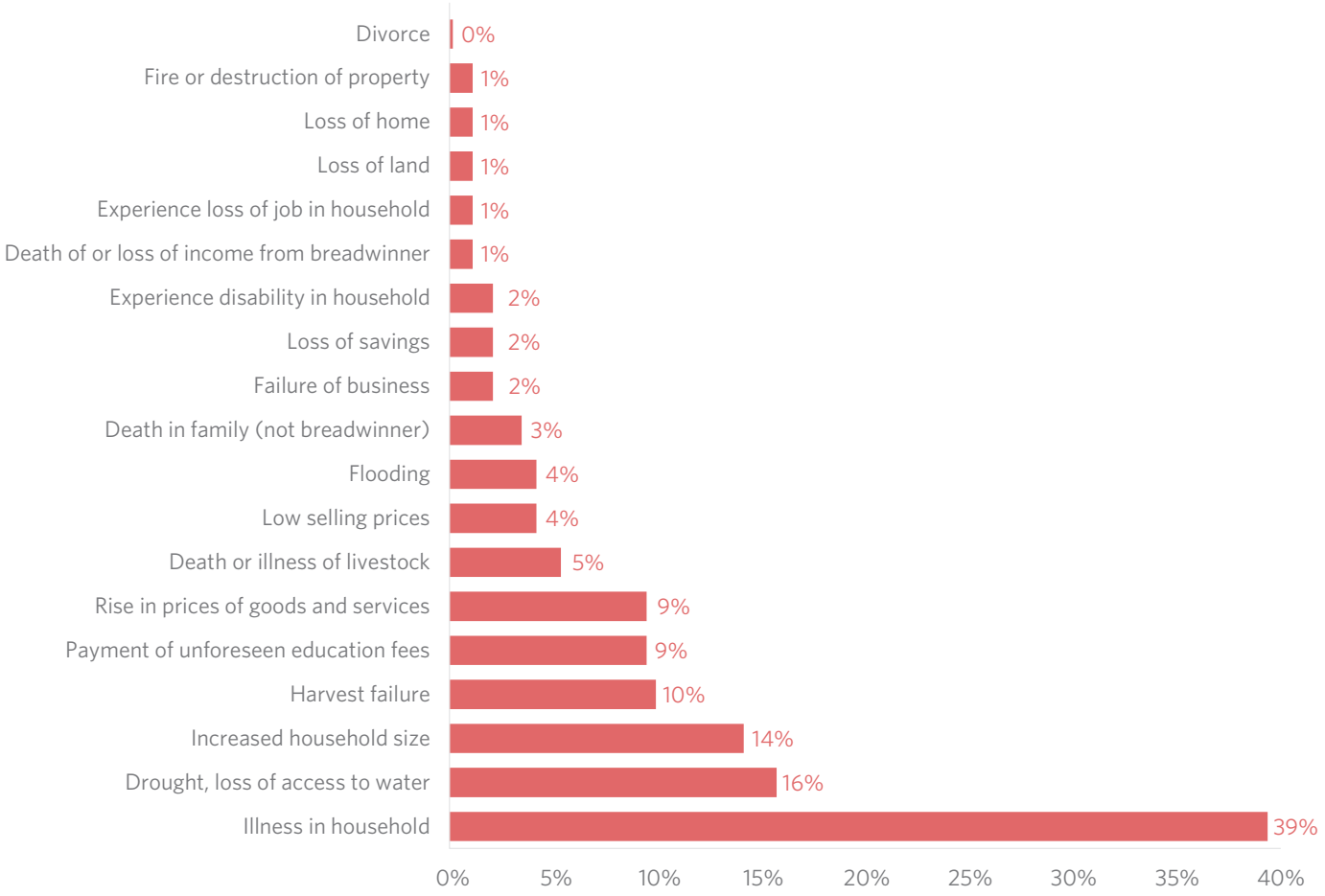


Figure 48: Risks events experienced by the adult population in the previous 12 months
Source: FinScope, 2014.

these use cases reflect uptake according to need in the market, these should not necessarily be construed as feasible market opportunities in all cases.

Medical expenses constitute the highest risk experience. As shown in Figure 48, medical emergencies pose a major risk to Nepali adults, with 39% of the adult population indicating illness in the household as the highest risk experienced. An illness within the household is also one of the main reasons for saving and borrowing – two products that show much higher uptake for this need. Therefore, a significant case for financial services support exists. However, while there is strong use case for health insurance, it is currently largely undersupplied.

Incentives in agricultural insurance. With farming as a key source of livelihood for many in Nepal, farming-related risks have the most widespread impact. Weather-based events, such as drought and loss of access to water, are among the risks most commonly experienced (16% of adults), while harvest failure was experienced by 10% of adults (see Figure 48). Furthermore, other agriculture-related risks, such as death or illness of livestock, were reported by 5% of adults in the previous 12 months. Given the 32% of adults farming in Nepal and 48% of adults earning their secondary income from farming, the current level of insurance uptake is likely an indication of an underserved market. The 2015 earthquake left the insurance industry relatively underwhelmed, which further goes to emphasise the low penetration of disaster insurance as a risk-mitigation tool.

Need for credit-life insurance. Banks and MFIs require credit-life insurance cover before they will grant a loan. Thus, over and above the use case for life insurance, this particular product category becomes an important insurance use case, especially for MSMEs and farmers, who rely on credit to establish and grow their businesses.

Cover income lost from death or disability. While death of an income earner or other family member is seen as a risk to income for only 1% and 3% of adults, respectively (as indicated in Figure 48), the loss of an income earner can have a significant and lasting impact on a household's ability to support itself; therefore, there is a strong use case for mitigating this risk for those that do face it.

Despite its lower relative recognition as a risk, life insurance is the product with the highest uptake among insured adults, at 44% (9% of total adults). (The figure of 44% includes credit-life insurance cover.)

Need for asset insurance. The fact that regulatory requirements mandate insurance in certain categories, such as motor vehicle insurance, has significantly increased uptake of such insurance products.

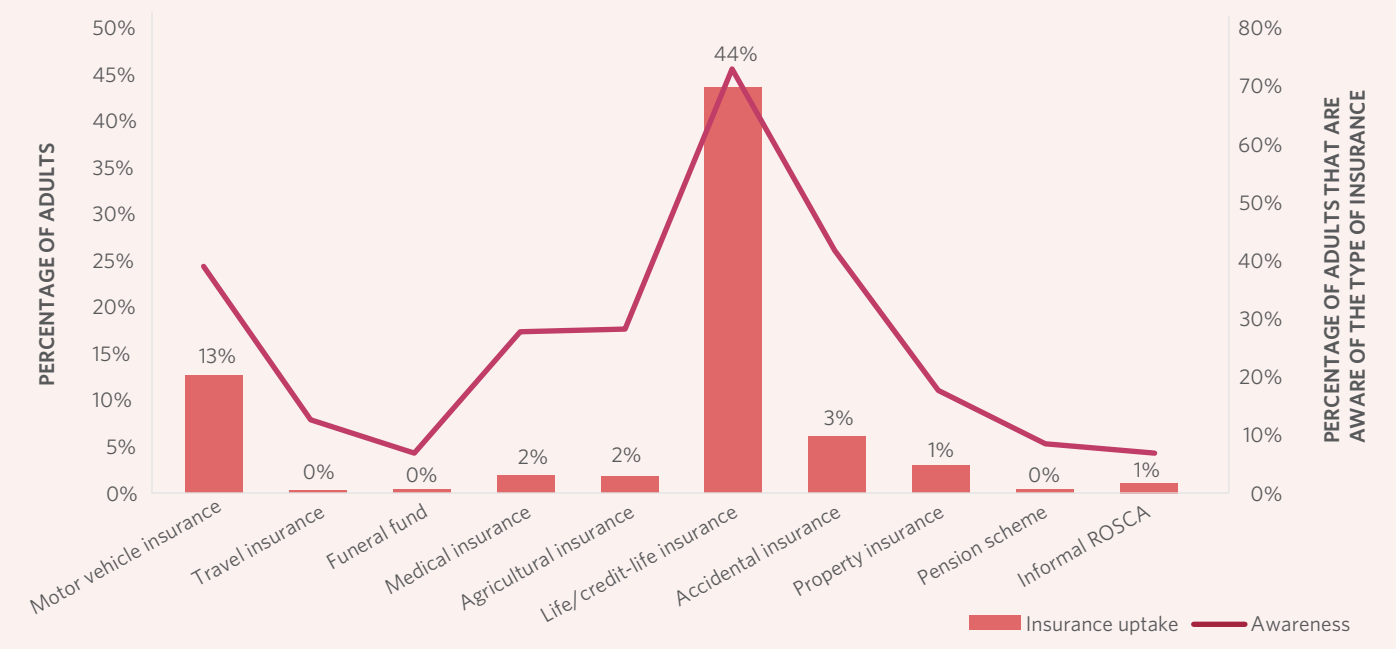


Figure 49: Insurance uptake among insured population and awareness among general population

Source: FinScope, 2014.

What products are available and in use?

Life insurance the most popular product. According to the Insurance Board, the main driver of the insurance industry in Nepal is life insurance, primarily the endowment and term life products. FinScope (2014) corroborates this information. Life/credit-life insurance has the highest uptake (44%) among the insured population. It is also the product that adults are most aware off. With low penetration levels, there is scope for potential product growth (see Figure 49).

Endowment products most popular in the life insurance segment. Further to the above, the most popular life insurance product was identified as endowment policies, that is, life insurance contracts designed to pay a lump sum after a specified term (on the policy's 'maturity') or on death. Typical maturities are 10, 15 or 20 years up to a certain age limit. Some policies also pay out in the case of critical illness. Endowment policies are commonly blended with various other schemes such as term life or whole life.

Recent trends also show a rise in popularity of anticipated endowment products among corporates – these are plans with a unique feature in terms of which a part of the sum assured is paid at certain intervals during the term of the policy and the balance of the sum assured together with the accrued bonus is paid at maturity. Anticipated endowment products include a cash-back feature (e.g. every four years) depending on the insurance scheme.

Endowment products are particularly popular among middle-income groups as they are seen as long-terms savings (MAP qualitative study, 2015). According to the Insurance Board and RBS, the popularity of life insurance products stems from their linkage with credit products at BFIs such as home loans and other loans. This has a wider scope as banks are also interested in safeguarding their assets.

Group schemes the majority of life market. Life insurance revenues are drawn from both individual and grouped schemes. According to RBS, grouped products are the most popular, with 60% of their portfolio consisting of grouped products and 40% of individual products (Rastriya Beema Sansthan, 2016). This is also because they cover big corporate houses such as NRB and Nepal Telecom Corporation. Meanwhile, according to Nepal Life Insurance Company, while they do offer grouped schemes, the policies themselves are treated as a group of individual policies and not as group policy, with a discount provided on the premium (MAP qualitative study, 2015).

Life insurance policy holders can access loans on the back of insurance products. General awareness about insurance products is relatively low. Consumers are therefore often unaware that in addition to the savings function of life insurance products, the product can be used as a basis for credit; loans can be accessed against one's life insurance policy at varying percentages of the surrender value depending on the company they are insured with (Insurance Board, 1993).

Embedded products in credit-life and savings category. Credit-life embedded products, provided by Prime Life Insurance Co. Ltd, are designed specifically for loan customers; the insurance company covers outstanding loans in case of the death of the borrower. A number of savings-linked insurance products are being introduced in the country, such as: Nepal Investment Bank's *Surakshya Bachat Khata* (security savings account), which provides free term life insurance of NPR 100,000 (US$ 1,015) for any cause of death, along with free accidental death benefit coverage of NPR 200,000 (US$ 2,030) (both for a period of five years minimum); and Siddhartha Bank's Special Savings Account, which comes with a benefit of free accidental death insurance coverage of up to NPR 500,000 (US$ 5,075).

Broad range of entry-level life insurance products under various categories. While product innovation is low, there is a range of life insurance products in the market that have low- and middle-income individuals and families as their major target customers (see Table 17). The minimum sum assured is as low as NPR 10,000 (US$ 101), while the minimum sum insured is NPR 100,000 (US$ 1,015) for certain endowment, child, and pension products. These are the most basic-level insurance products available on the market. Table 17 also provides an overview of the key features and benefits of a number of such products, although this is not necessarily a comprehensive list of all products available on the Nepali insurance market.

Product type	Product	Provider	Features and benefits
Life	Life Endowment	Nepal Life Insurance Company, Surya Life, Asian Life, Prime Life, Gurans	Features: Minimum assured sum NPR 25,000; with profit policy. Benefits: Sum assured plus bonuses payable on maturity; in case of death before maturity, sum assured plus bonuses payable to nominee.
	Life Endowment	National Life, Metlife	Features: Minimum assured sum NPR 50,000; with profit policy. Benefits: Sum assured plus bonuses payable on maturity (only face amount payable in Metlife's Endowment Plan); in case of death before maturity during policy period, sum assured plus bonuses payable to nominee.
	Plan number 333	LIC	Features: Minimum assured sum NPR 10,000; with profit policy. Benefits: Sum assured plus bonuses payable on maturity; in case of death before maturity, sum assured plus bonuses payable to nominee.
Dependants	Child Endowment	LIC, Surya Life, Asian Life, Prime Life, Gurans	Features: Minimum assured sum NPR 50,000; with profit policy. Benefits: Sum assured plus bonuses payable on maturity; in case of death after commencement of risk but before maturity, sum assured plus bonuses payable with vested bonus to nominee. In case of death before commencement of risk, all the premiums (excluding extra premiums e.g. paid for riders benefit) are refunded. *Full sum assured, plus bonus on maturity on death.
	Child's Marriage and Educational Endowment Plan	National Life Insurance	Features: Minimum assured sum NPR 10,000. Benefits: Sum assured plus bonuses payable on maturity; in case of death, premium is waived till maturity; sum assured plus bonus earned is paid to the nominee (child) on maturity.
	Education Protection Plan (EPP)	Metlife	Features: Minimum assured sum NPR 50,000. Benefits: Sum assured plus bonuses payable on survival of child at maturity. In case of death of child before maturity, sum assured plus bonuses are payable subject to Juvenile Endorsement. In case of payer's death, all future premiums are waived and the policy continues; income for education at 1% of sum assured is paid each month to the child till policy maturity and at maturity, sum assured and bonus are paid. *Option for additional benefit relating to payer's disability.
Credit -life	Prime Life Karja Surakshyan (mortgage redemption insurance)	Prime Life	Features: Special policy for financial institutions' loan customers, lower premium rate due to absence of savings factor, reducing coverage of the insurance corresponding to customer's reducing outstanding loan balance Benefits: In case of death, outstanding loan due to financial institutions is paid by Prime Life.

Table 17: Entry-level products in the life insurance segment

Source: Authors' own and in-country consultations, 2015.

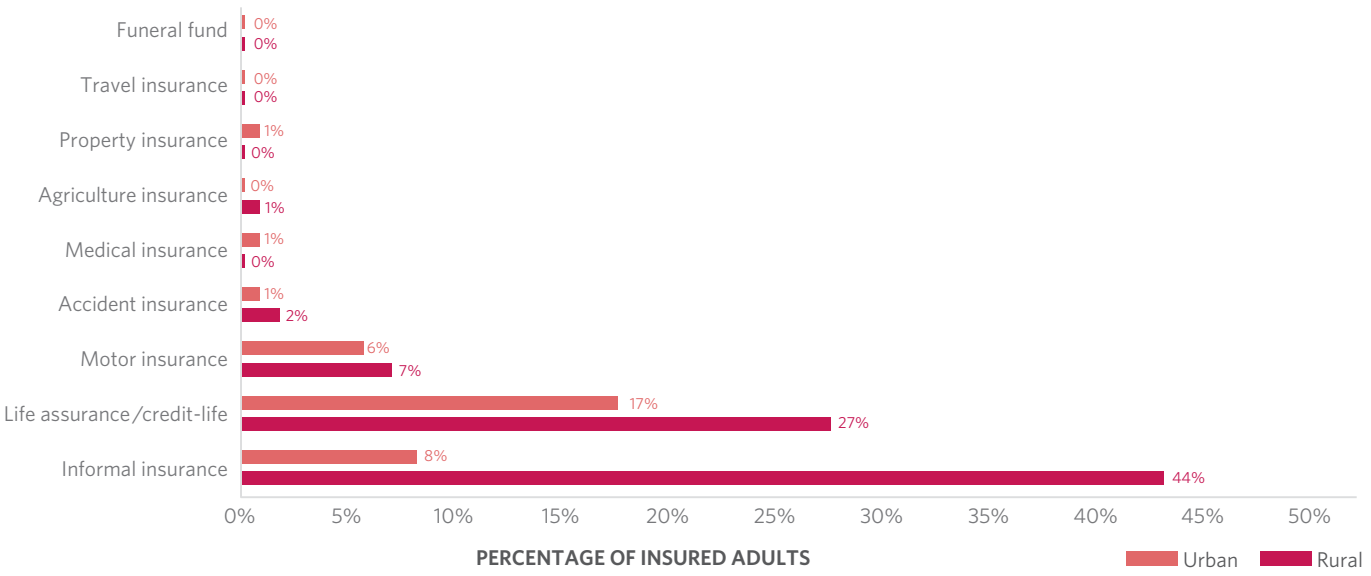


Figure 50: Insurance product uptake among insured population, by location
Source: FinScope, 2014.

Motor vehicle most popular in the non-life segment. According to the Insurance Board, the non-life insurance industry in Nepal is largely asset insurance driven, primarily motor vehicle insurance (see Figure 49). FinScope (2014) corroborates this information, with motor vehicle insurance being the second most popular product among the insured population, at 13% of that population. The high use of motor vehicle insurance is primarily due to the mandating of third-party motor insurance for all motor vehicles for a minimum of NPR 5 million (US$ 50,746), and the fact that motor insurance is generally required by institutions that finance motor vehicle purchases. However, it should be noted that these products only reach 3% of the adult population.

Motor insurance provided by all providers. All 17 non-life insurance companies in the country provide motor insurance. Most of these products have two categories: comprehensive policy – which covers risks against owner's legal liability to third party in case of death or injury, along with coverage for damage of insured vehicle, driver and passengers' accident; and third party liability policy – which only covers the owner's legal liability to third party in respect of death or bodily injury (MAP qualitative study, 2015).

The majority of insured adults live in rural areas. Figure 50 indicates the location of insured adults per product type. The graph indicates that most insured adults live in rural areas. This is due to the fact that the majority of Nepal's adult population (81%) live in rural areas. The uptake of informal insurance is particularly strongly skewed towards adults living in rural areas: 52% (including overlaps) of insured adults insure their risks informally and live in rural areas.

Low levels of innovation in the insurance market. Based on the MAP Nepal supply-side analysis, it is clear that the product range provided by insurance companies in Nepal is a fairly standard, general insurance offering, with insurance providers displaying low levels of innovation. The strict regulatory environment of the insurance industry also inhibits growth and innovation, thus hindering the industry. For instance, regulation mandates insurance companies to invest 100% of their premiums in a shallow local market. Furthermore, high capital requirements negatively affect insurance companies' profitability by limiting the funds that can be invested. The Insurance Board is considering raising the capital requirement for insurance companies even further, with a proposed draft under consideration at the Ministry of Finance. (The potential impact of this regulation is discussed in the sub-section on what regulatory and policy issues need to be considered.)

Limited micro-insurance penetration across a range of product categories. The micro-insurance product categories available in the market range from medical care, to life, agricultural, livestock, housing, accidental, and maternity. According to Metlife, the claim ratio in the micro-insurance sector is relatively high, with the number of micro-insurance claims in the past 3 years exceeding 13 years of other insurance claims. The high claims ratio is an indication of the value that consumers derive from the products, but it also indicates that insurers might find it difficult to be sustainable in this market.

Space for insurance products following natural calamity. With the country being susceptible to natural calamities (e.g. the April 2015 earthquake), the risk to income is likely to increase. Consequently, there is a significant use case for insurance products that protect people's income or assets against such events.

In the agriculture sector, while the government has introduced tax incentives to promote and stimulate the growth of agriculture and livestock insurance with products such as 'Commercial Livestock Insurance', 'Milk Cooperative Managed Livestock Insurance' and 'Weather-based Crop Insurance' under the Agriculture Development Strategy 2015–2025, this market is still underdeveloped because insurance companies often lack the necessary technical knowledge on valuing and pricing these products so as to make them viable for this target market segment.

Product	Provider	Features
Micro-insurance	United Insurance	Risk coverage in the agriculture and livestock domain, including birds, livestock, crop, fish, fruits, vegetables etc.
	Centre for Self Help Development	Life, housing and livestock.
	Other	Medical care, life, agricultural, livestock, housing, accidental and maternity.
Agricultural Insurance	Everest Insurance	Provides insurance coverage for farming of: livestock, poultry, fish, paddy, vegetables, fruits etc. and covers against risks of fire, natural calamities, diseases, insects.
	Shikhar Insurance	Provides insurance coverage for farming of: livestock, poultry, fish, paddy, vegetables, fruits etc. Insurance coverage for farming against the risks of fire, natural calamities, diseases and insects.
	NLG Insurance	Provides insurance coverage for the following: cattle, crops, vegetables, fish, poultry.
Motor Insurance	Nepal Insurance Company	Coverage of risk associated with an auto accident or other vehicle damage.
	The Oriental Insurance Company	Covers loss or damage to the motor vehicle and/or its accessories while on land or in transit; third-party liability; rates are based on types of vehicles, cubic capacity/ carrying capacity.
	United Insurance Company, Prabhu Insurance, Rastriya Beema Company, Siddhartha Insurance, NLG Insurance	Two types of insurance policies under motor insurance, viz. a) comprehensive, or b) third-party liability restricted to liability in a) and not the insured's vehicle.
	Premier Insurance Company	This policy indemnifies vehicle owners against the risk of incurring legal liability to pay compensation to a third party for death, bodily injury, property damage arising out of use of vehicle and loss due to accidental damage to own vehicle itself. Private car, motorcycle, commercial vehicle owners can access this insurance cover against comprehensive risks including third-party personal injury and property damage and additionally riot & strike, earthquake, flood, personal accident to passengers, drivers etc.
	Sagarmatha Insurance	Covers against loss or damage caused by accidents and the policy owner's legal liability to third party for bodily injury or property damage.
	Lumbini General Insurance	Comprehensive vehicle policy covers the damage of insured vehicle and the third-party liability along with coverage for personal accident of the driver and the passengers.
	Prudential Insurance	Covers only the insured's liability to third party in respect of death or bodily injury or damage to property and the loss or damage to vehicle by accidental or external means.
	Shikhar Insurance	Under comprehensive policy, damage to the insured vehicle as the third-party liability is covered along with coverage for personal accident of the driver or passengers.
	NB Insurance, Everest Insurance	Covers damage of vehicles and third-party liability under comprehensive vehicle policy. Coverage also for personal accident of the driver, passengers, helpers and conductors.
	Himalayan General Insurance	Policies can be issued on comprehensive basis, which covers own damage and third-party legal liability or for third party only.

Table 18: Entry-level products in the non-life insurance segment

Source: Authors' own, and in-country consultations, 2015.

Who are the providers?

Concentrated life insurance sector, but a wider competitive basis in the non-life market. While there are fewer life insurance providers compared to the non-life market (9 providers in life compared to 17 in non-life), life insurance is the most popular product. The insurance landscape, as identified in the provider overview section of the report, has remained stable, with no new entrants to life insurance since 2008, and no new entrants to non-life since 2005.

Government-owned Rastriya Beema Sansthan splits its life and non-life segment. Rastriya Beema Sansthan (RBS), the only state-owned insurance company providing both life and non-life insurance in Nepal, split into two businesses in 2014. This change occurred following the Insurance Act (1992), which prohibited insurance companies from providing both life and non-life insurance products. Nepal Beema Company, a separate public limited company, was formed to handle RBS´s non-life business. RBS now operates only life insurance business and is governed under the law of *Beema Samiti* (the Insurance Board). While the government had attempted to implement the law in the past, it had failed to split the life and non-life business of RBS due to protests from employee unions.

Private players dominate the market. Currently, only 7% of players in Nepal's insurance industry are public, and 93% are private companies: 3 companies are foreign owned, 3 are joint investments with foreign companies, 18 are privately owned, 1 is a joint venture reinsurance company and 2 are government-owned companies.

Relatively stable provider landscape. Both the life and non-life insurance provider landscapes have remained relatively unchanged for many years. Apart from the change introduced when RBS's non-life insurance business was split off from RBS to form Nepal Beema Company, the most recent life insurance company to be set up was in 2008. Prior to 2000, only RBS and National Life Insurance Co. Ltd served the life insurance segment. The non-life insurance market has not seen new entrants since 2005, when three companies were established.

Nepal's first reinsurance company established. Nepal's first reinsurance company, Nepal Reinsurance Company Ltd, was established in November 2014. Given the slow development of the insurance industry in Nepal and the lack of a domestic reinsurance company, providing insurance is relatively more expensive for service providers. However, the establishment of the reinsurance company is expected to curb the massive fund outflows for reinsurance purposes, and ease the provider landscape.

Distribution

Agent-based model the primary tool for insurance penetration. The MAP qualitative demand-side study (2015) indicates that most distribution still occurs through traditional channels: the agent-based model. While this is changing in urban areas, agents still act as the primary link between the customer and the company. This is particularly the case in rural areas, which are completely dependent on agents in terms of awareness of insurance products. In order to better tap into a wider market, it is essential that agents be trained better in terms of insurance awareness and benefits.

BFIs involved in the insurance sector in Nepal through bancassurance. The relatively less-used distribution channel in Nepal is a model whereby banks act as the agent and sell insurance products, either linked with their credit products or as bancassurance. The uptake for bank-generated insurance products is generally in urban areas. More recently and particularly in rural areas MFIs have been acting as agents to insurance companies, thereby increasing penetration and reach.

What are the barriers to usage of insurance services and products?

Notwithstanding a stable provider landscape and products on offer that can cater to the needs of a wide range of Nepalis, a number of barriers inhibit access to, or usage of, insurance at scale.

Access barriers

Affordability a key barrier. A key barrier, even where the population is aware of insurance, is affordability. As mentioned earlier, average income levels in Nepal are relatively low, with 75% of adults earning less than NPR 10,000 (US$ 100) per month. This applies to both rural and urban areas, but is more pronounced in the former as the largest target market is primarily located in rural areas (see Figure 51).

"We only earn about Rs. 100–500 [US$ 1-5] a day depending upon business. We do not have the required money to do insurance. As we are sending our children to school we do not have much of a saving. Whatever we can save we deposit in the Cooperatives. The rest is required for our daily expenses as well." (Teashop owner)

High level of irregular incomes. A large proportion of the population is dependent on various types of irregular income. Farming, as a livelihood, is prevalent in Nepal and many people are dependent on piecework for income. Therefore, especially in rural areas, it is almost impossible for adults to commit to regular premium payments due to the unpredictability and irregularity of their incomes.

Lack of proof of income an eligibility barrier for insurance. Most adults (92%) have the basic eligibility requirement of a national ID card. However, only 5% have proof of income (FinScope, 2014). Adults' inability to prove their income acts as a deterrent to purchasing insurance products.

"I don't have a citizenship card due to which I cannot get such access at all, as insurance companies require citizenship as a compulsion. Only one Cooperative provided an account where I can save my daily earnings." (Rickshaw driver)

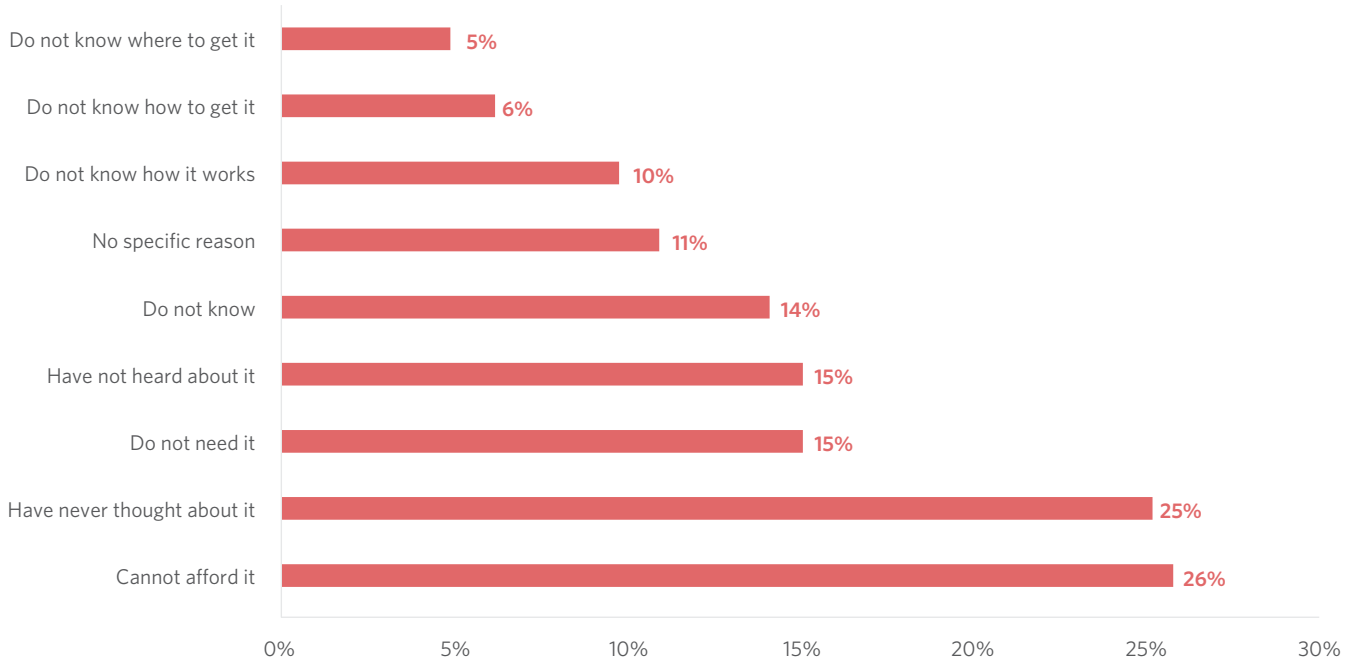


Figure 51: Reasons why Nepalis do not take up insurance
Source: FinScope, 2014.

Proximity and infrastructural bottlenecks a key barrier in rural areas. A key issue in terms of access, particularly in rural areas, is the lack of infrastructure and support resources of insurance companies. Insurance companies are not keen on opening physical branches in rural areas due to high operational costs, and this results in a high dependence on the agent model, in terms of which agents become the interaction point with all rural customers (MAP qualitative study, 2015).

The fact that agents are usually not well educated and lack professional training exacerbates the problem of limited awareness of insurance products; agents are often unable to clearly explain the importance of taking up insurance in terms of security, tending rather to focus on returns or discount rates (MAP qualitative study, 2015).

Furthermore, the agent model is considered unreliable as there have been cases of agents not following up on collection of premiums over the years; in such cases, with the nearest insurance office located far away, customers are often left with no option but to forfeit their policy.

Usage barriers

Awareness levels the foremost barrier for the insurance industry in Nepal. The relatively low levels of awareness and financial literacy with regard to the insurance industry are among the primary reasons for the low penetration of the insurance industry in Nepal. For instance, 10% of adults say that they do not know how it works, 6% that they do not know how to get it, and 5% that they do not know where to buy insurance (see Figure 51). Awareness and literacy about insurance – even life insurance, which is the most popular product among the insured population – is relatively low in urban and rural areas alike. Furthermore, with stringent controls on marketing costs of insurance companies, which are not allowed to exceed 14% of total expenditure, insurance companies are limited in terms of their capacity to generate awareness.

"I have not understood the concept of life insurance at all. Plus, working under someone else's car there's not much of saving at all. I have only done insurance of my taxi because our committee of taxi drivers requires insurance of vehicles compulsorily. If I had enough money to pay for life insurance premium then I would rather buy a new car, rent it to another driver and earn more money." (Taxi driver/grocery store owner)

Negative perceptions of insurance. In addition to the low levels of awareness and financial literacy with regard to insurance, the low levels of general exposure to the insurance industry in Nepal mean that a significant proportion of the adult population fail to see the value of insurance. With BFIs mandating insurance cover for certain products, insurance is often a grudge purchase, accessed because it is mandatory or because it is bundled. The general perception among the adult population is therefore of insurance being a sunk cost, rather than a mechanism to offset risk events. In addition, claiming on insurance is considered to be a very tedious process.

However, gradually awareness and perceived value, particularly on the micro-insurance front, are increasing, as evidenced by increases in the claims ratio.

A lack of trust not a driver of limited insurance uptake. Only 3% of adults indicated that a lack of trust in insurance companies was the reason why they did not purchase insurance (FinScope, 2014). Therefore, trust is not an important barrier in the insurance market.

What regulatory and policy issues need to be considered?

Insurance uptake driven by mandatory insurance coverage. Regulatory requirements mandate insurance in certain categories, such as motor vehicle insurance or with bundled products, which has significantly increased uptake of insurance products (MAP qualitative study, 2015). This trend is likely to continue for essential products. For instance, the Insurance Board is attempting to introduce bottom-line products around migrant workers, mandating them to take life insurance. Such regulations are likely to drive the uptake of insurance products further (MAP qualitative study, 2015).

Investment avenues curtailed by government regulation. As per Insurance Board investment directives, funds that remain with the insurers after the payment of claims and other expenses are to be invested by the insurers. Insurance companies are restricted to investing their funds only in sectors and avenues specified by the insurance guidelines; for instance, there is a statutory requirement that 25% of total investments need to go to government bonds or treasury bills. As a result, providers are currently facing challenges to diversifying investment funds, and this seriously hampers potential returns (Institution, 2016).

Increase in requirement of paid-up capital of insurers. The Insurance Board has issued a circular (5 January 2016), directing insurance companies not to distribute cash dividends, in order to comply with the proposed increase in paid-up capital. A draft bill is under review at the Ministry of Finance, and once approved it will replace the existing Insurance Act (1992). The required paid-up capital is set to increase to NPR 5 billion (US$ 50.74 million) from the current NPR 0.5 billion (US$ 5.07 million) for life insurance companies. For non-life insurance companies, paid-up capital is set to increase to NPR 4 billion (US$ 40.6 million) from the current NPR 250 million (US$ 2.53 million) (*The Kathmandu Post*, 2015). The expectation is that this will assist insurers to meet a huge amount of liabilities, and thereby expand their business. Insurance companies will have to increase their paid-up capital within two years of the new Act coming into effect. This move on the part of the Insurance Board will likely trigger a merger and acquisition spree among the insurance players, substantially bringing down the number of insurance companies in the process (Ghimire, 2015).

Insurers required to maintain a higher solvency margin. The draft of the insurance law maintains that insurance companies will have to maintain their solvency margin (the ratio between total capital and total liabilities) at not less than 1.5. This is the same solvency margin required of insurers in India. Nepali insurers with a solvency margin below 1.5 will be required to increase their total assets. While this does have positive implications, in that insurance companies will be better able to deal with unforeseen increases in claims, it could also have negative implications in terms of reduction in bonus rates, making life insurance unattractive compared to other financial instruments.

Micro-insurance policies to be sold as directed by the regulator. Within the next five years, as directed by the regulator, all insurance companies will have to sell micro-insurance policies to the value of 15% of their total policies (*FinancialNepal, 2016*). Insurers have pointed out the need for innovative and technology-driven micro-insurance products for poor people, because high management costs are among the major obstacles to insurance coverage expansion (MAP qualitative study, 2015).

Assessment of financial position of insurers. According to the draft of the new insurance law, all insurance providers will have to annually reassess their financial position, including assets and short- and long-term liabilities, and submit a report to the Insurance Board. The assessment has to be done by a person licensed by the Insurance Board. Furthermore, companies found selling insurance policies without a licence will be penalised; their assets will be confiscated and the proprietor will be fined a sum equivalent to three times the company's worth and jailed for 3–10 years. These requirements and sanctions are likely to change the business model as well as viability of insurers.

Product offerings confined and regulated. Currently, the Insurance Board regulates the product offerings of the insurers present in the country. Hence, the insurers are restricted to selling the same insurance products and are forced to charge almost the same premium as their peers. This has implications in terms of the fact that most providers have a homogeneous set of products with little innovation or basis for differentiation among customers.

Crop and livestock insurance directives introduced. The Crop and Livestock Insurance Directive was introduced by the Insurance Board in 2013 to provide insurance coverage and financial support to farmers in case of failure of any of the notified crops as a result of natural calamities, pests or diseases. The directives are aimed at: encouraging farmers to adopt progressive farming practices, high-value input and technology in agriculture; stabilising farm incomes, particularly during disaster years; helping in the commercialisation of agriculture; and promoting investment in agriculture by private sector cooperatives. The directive is also endorsed by the Government of Nepal under the Crop and Livestock Insurance Premium Subsidy Directives 2013, which provides a premium subsidy of 75% for crop and agricultural insurance. This initially covered only informal agricultural-sector farmers, but has now been extended to organised farming subsidies as well. This subsidy has therefore attracted organised agriculture/livestock sectors to purchase insurance.

What and where are the gaps and opportunities?

Lowest-hanging fruit is to further reach salaried workers and MSMEs. Despite their higher and more stable incomes than the other target market segments, only 29% of salaried workers and only 23% of MSMEs currently have formal insurance (FinScope, 2014). This indicates a substantial portion that remain untouched, but could feasibly be reached. These employees tend to be wealthier (can afford premiums), are more educated (have the capability to engage with insurance), and more urban (more easily accessed). Furthermore, due to the potential to aggregate salaried workers through group-based products and to collect premiums through existing bank accounts, insurance companies

could more quickly, affordably and efficiently launch products for salaried workers compared to products for the other target market segments.

Capitalising on life insurance as a savings tool. With life insurance being the most popular insurance product among the adult population, in terms of both awareness and uptake, and with Nepal already having a strong culture of saving across all of the target market segments, there is a substantial opportunity to market life insurance as a savings tool among those in the middle to upper end of the market. This will couple the uptake of insurance with the need to save and therefore increase incentives to consider the product.

There is a significant opportunity to increase the uptake of life insurance products by improving on the tax incentives provided (currently very nominal).

There is also a significant opportunity to increase awareness of the possibility of accessing loans by virtue of having a life insurance policy.

Capitalising on credit-life. Given that banks and MFIs require credit-life insurance cover before they will grant a loan, credit-life insurance merits further attention as a means of expanding uptake of formal insurance – especially by MSMEs and farmers, who rely on credit to establish and grow their businesses.

Prioritise medical insurance products. With medical costs being among the greatest risk events faced by the adult population (FinScope, 2014), there is a significant potential for the uptake of medical insurance across all target market segments. Currently, only 2% of the insured population has medical insurance, which indicates a space for large-scale progress. Beyond comprehensive medical cover, which is only likely to be affordable to the top end of the formally employed market, there is likely to be scope for affordable insurance *not directly related* to the cost of care, but rather providing a cash pay-out towards expenses upon a health trigger (e.g. some life insurance policies have a category whereby, on determining a certain ailment, a lump sum pay-out is provided under the policy

Mandatory products drive uptake and awareness of insurance. As already mentioned, mandating of insurance products in certain categories has helped to improve insurance uptake as well as exposure to insurance. Mandating insurance can therefore help further drive uptake. A softer – and probably more pragmatic – form of this is *bundling* insurance products with other products (financial and other) that display a stronger market demand and have an insurable risk attached.

Natural disaster risk cover potential. Cover for natural disasters, particularly in highly agrarian economies, is a key area of opportunity. While agricultural insurance is operational, it has not reached sustainable scale. However, opportunity exists to learn from these experiences for future market interventions. The income level of the majority of farmers makes insurance for these risks largely unaffordable without premium subsidies, so this could be an area of opportunity for government or interested parties to support farmer development.

Insurance companies to focus on improving technical knowledge on valuing and pricing. As already mentioned, under the Agriculture Development Strategy 2015–2025, the government has introduced tax incentives to promote and stimulate the growth of agriculture and livestock insurance with targeted products (e.g. 'Commercial Livestock Insurance', 'Milk Cooperative Managed Livestock Insurance', 'Weather-based Crop Insurance'). The market remains underdeveloped, however, because insurance companies mostly lack the necessary technical knowledge on valuing and pricing these products to make them viable for this target market segment. This presents a significant gap and opportunity.

More professional agents and more effective communication essential for insurance penetration. Currently, it is relatively easy for insurance agents to get a licence with just four days of training. Education of agents as well as the target market segments is therefore essential to improve awareness and acceptance of insurance products. While financial literacy is essential, it is also imperative that it be matched with a supply-side effort to communicate effectively to an audience with low exposure to insurance and low literacy levels.

Summary: Financial service usage across product markets

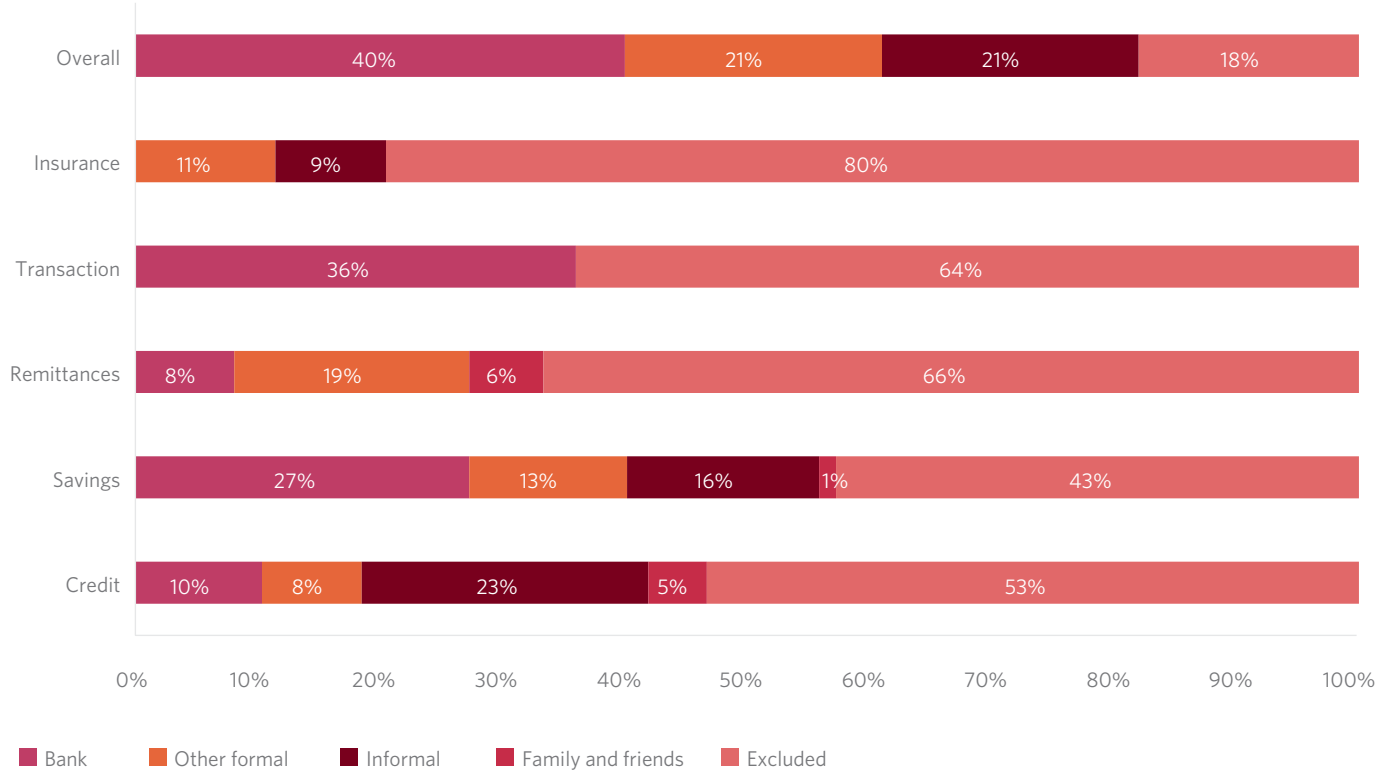


Figure 52: Financial service usage across the four product markets (savings, payments, credit, insurance)
Source: FinScope, 2014.

Savings and payments most commonly used financial services. Savings are the most commonly used product for the adult population, with 57% of the adult population indicating that they save.

This is followed by 46% of adults accessing credit, 36% of adults taking up transactions, 33% remittances and 20% insurance.

Both formal and informal savings products are key. Of those who do not save in a bank, 13% use other formal savings products and a further 16% of adults without access to formal services use informal saving only.

When overlaps between usage are taken into account, though, 31% of adults overall use informal providers, making these the dominant channels for savings (FinScope, 2014).

Informal providers are key players for credit. Credit is the second most accessed financial service. Most borrowers access credit through informal channels:

- 23% of adults access credit exclusively from informal providers.
- 18% of adults access credit exclusively from formal providers.

In total when overlaps are taken into account, 29% of adults take up credit from informal sources. Of those that do use formal services, only half of this uptake is through a bank.

The majority of Nepalis rely on cash or barter for transactions. Payment networks in Nepal are still in their infancy. Banks are effectively the only provider of digital transactions, with 32% of adults transacting from a range of account types (FinScope, 2014). When adults with bank accounts were surveyed, only 10% indicated that they use the account to transact (FinScope, 2014). Transacting to purchase goods and services is a need that applies to a large percentage of the population, and therefore the low formal uptake is an indication that the majority of transactions are taking place in cash or informally through barter of goods and services.

Intermediated remittance most common. Just over a third of the adult population (33%) make use of remittance products, with the majority doing so through 'other formal' providers.

Access via the other formal provider channel is by:

- 19% of those that do not use banks.
- 21% of the total adult population.

In terms of total uptake, use of banks (8%) for remittance is closely followed by use of family and friends (6%).

Insurance uptake is low. A very small proportion of the adult population in Nepal has formal insurance, with 80% completely excluded from the insurance market.

Of the 20% of adults that are insurance users, the split between use of formal and informal providers is very close (including overlaps between the two channels):

- 56% with formal insurance.
- 52% with informal insurance.

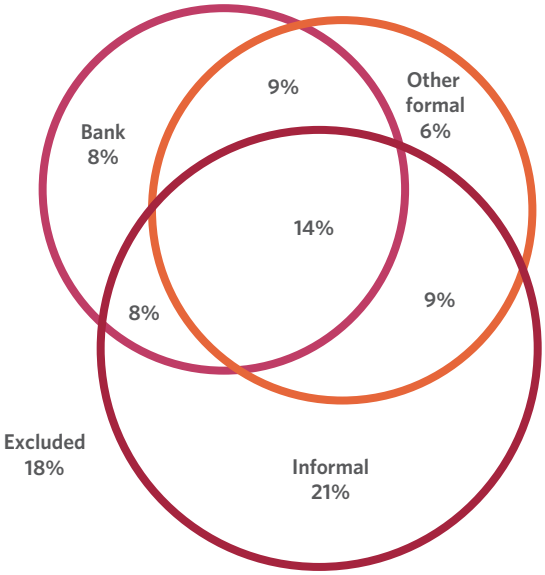


Figure 53: Overlaps between the product categories
Source: FinScope, 2014.

Depth of usage

Figure 53 illustrates the overlaps of financial service usage. Each circle is proportional to the number of adults that use that category of financial service. The percentage in each segment indicates the percentage of the total adult population that falls into that category. For instance, the segment where bank and 'other formal' intersect consists of 9% of the adult population. Therefore, 9% of the population use both a financial service provided by a bank and one provided by another formal institution. The diagram allows one to have a closer look at the usage of multiple financial service types.

Major overlap between provider channels. As shown by Figure 53, overlaps between formal channels and informal financial usage is high, at 14% of adults.

Adults that use only informal financial services make up the largest share of the population (21%), followed by adults that only use bank financial services (8%) and other formal (6%).

The top area of overlap is the 28% of adults that access financial services through both other formal and informal providers, followed by the 23% of adults accessing bank and other formal providers, and the 22% of adults accessing bank and informal providers.

This indicates that *informal* financial services play an invaluable role in the Nepali financial market, alongside their formal counterparts. To cater for their financial needs, adults either use informal providers only, or, if they use formal services they use them in tandem with informal services. In general, there are major overlaps, with 45% of adults accessing financial services from more than one provider channel.

Low usage of more than one formal financial service. Figure 54 indicates the incidence of use of a portfolio of financial services, i.e. the percentage of adults that make use of more than one financial service at any given time. As indicated:

- 58% of adults use more than one type of financial service. Of those that use two financial services, the most popular combination is savings and transaction services (12% of adults).
- A small proportion (7%) of the adult population uses all four types (services from all four financial product classes).

Lack of good-quality, relevant financial products. Although 60% of Nepali adult consumers have access to formal financial services, the following is worth noting:

- 25% of the total adult population use formal services to access only one type of service – either savings, payment, credit or insurance. This points to the low usability of existing products on offer and/or the lack of products that meet the needs of the target market.

FinScope data has shown the following in terms of use of *formal channels*:

- 9.3% of the population use them for borrowing only.
- 8.3% use them for payments only.
- 7.2% use them for savings only.

Only 7% of adult consumers use formal channels for all four products classes, which suggests underlying issues relating to lack of availability of good-quality, relevant financial products. The MAP qualitative research also showed that individuals accessed credit rather than insurance to cover the expenses associated with risk events; this reflects a lack of quality and/or relevance in terms of available financial products.

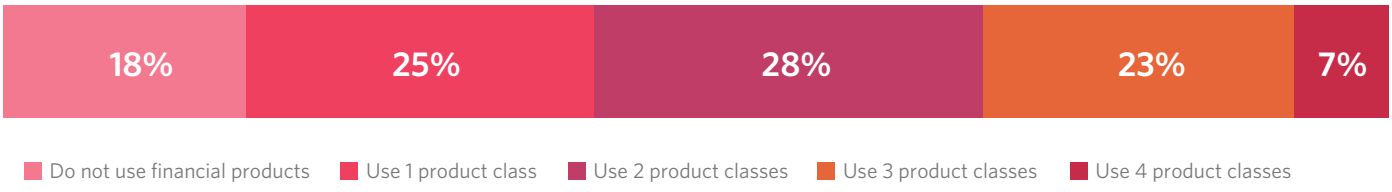


Figure 54: Multiple financial product usage by Nepali adults
Source: FinScope, 2014.

Providers

Summary

- The four categories of financial institution have witnessed rapid growth in the past 10 years and are currently undergoing consolidation.
- Formal financial services are clustered around urban and peri-urban areas, with the result that those in rural areas lack easy access to such services.
- Salaried workers and MSMEs are the most banked sectors.
- Informal channels of financial service provision have widespread usage among all target market segments.
- Insurance has low uptake and is mainly taken because of mandatory requirements (in some cases to access credit).
- There is a very high density of formal financial institutions in the market.
- Commercial banks (class A) are the biggest providers, in terms of both assets and market share.
- Informal financial service providers serve the largest number of adults.
- Life insurance companies are significantly larger than non-life insurers.
- There is a single stock exchange, dominated by scrips of banking and financial institutions (BFIs).
- The stock exchange is not looked upon by businesses as a source of long-term equity.
- Digitisation of scrips and transactions is enabling faster and more cost-effective clearance of transactions.
- Poor banking infrastructure and the high cost of operations is restricting BFIs from spreading their reach in rural areas.
- Mobile technology has been adopted – but in the absence of regulations its proliferation and usage remain constrained.
- Value chain financing exists, but is mostly informal. A few donor-driven projects are attempting to institutionalise the process.
- BFIs are partnering with retailers to expand their networks; however, the services being provided are very limited.
- The department of postal service offers postal savings accounts but has been largely ineffective. BFIs have not explored the partnership option with the postal service to leverage its network and rural market due to bureaucratic obstacles.

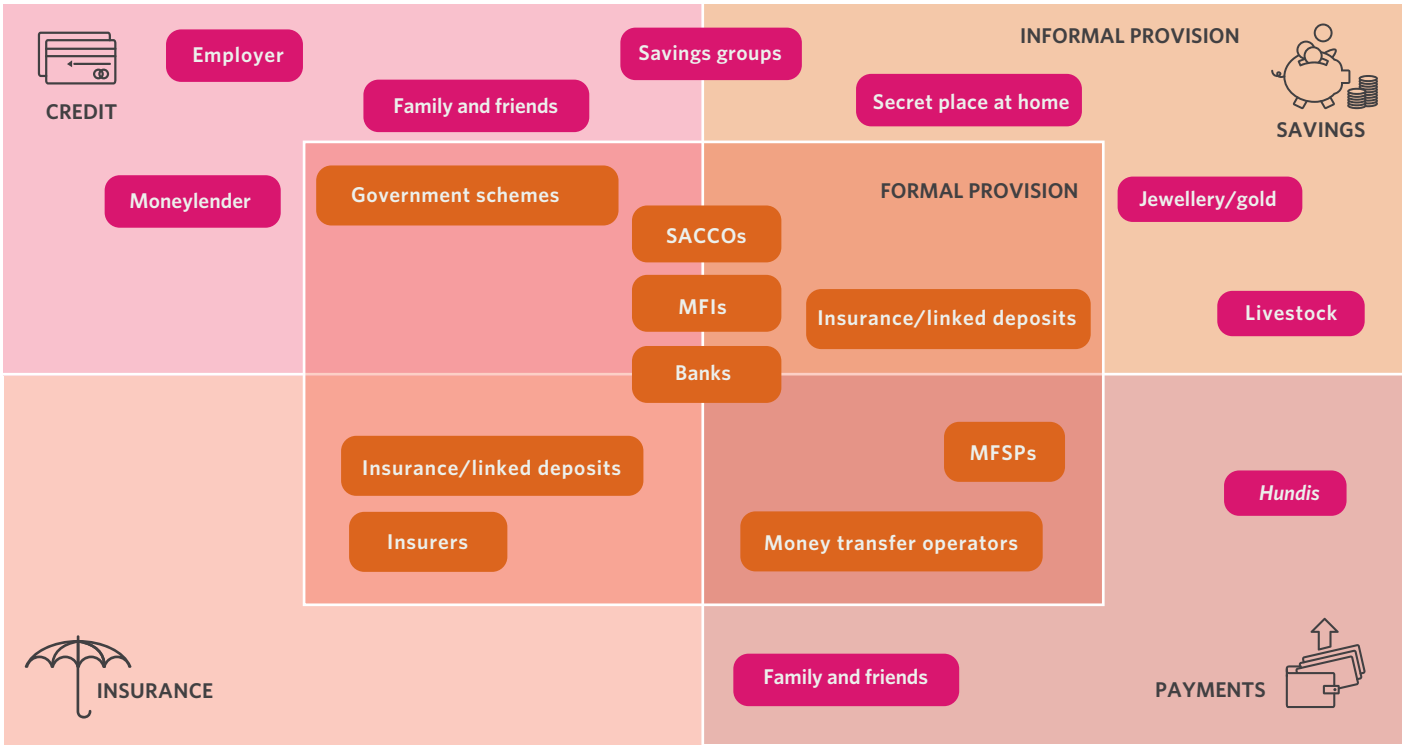


Figure 55: Overview of providers currently operating in Nepal

Financial service providers and cross-cutting issues

In Nepal:

- 57% of the adult population rely on *informal* financial service providers – i.e. FSPs that are unregistered and/or unsupervised – to meet their financial service needs.
- 60% of adults rely on *formal* FSPs – i.e. they are both formally registered and fall under a supervisory framework (FinScope, 2014).

Figure 55 provides an overview of formal and informal providers in Nepal. It shows whether a provider falls into the formal or informal category, as well as which product markets the provider serves. Some providers only service one product market category, but other providers – e.g. banks, MFIs and SACCOs – service a range of categories. The providers that fall into informal provision are all also local. In addition, two of the formal providers – SACCOs and MFIs – are active in local provision of financial services.

Note that Figure 55 shows an overview of providers and not of their distribution channels; for example, banks are direct *providers* of credit, savings and payments products, but are a *distribution channel* for insurance – and therefore they are not shown as a provider in the insurance product market section of the diagram (although they are depicted as overlapping with the insurance section of the diagram because they act as agents for insurance companies).

Formal financial institutions grew rapidly and are now undergoing consolidation. Figure 56 shows the timeline of the growth of Nepal's financial institutions in the past 20 years. It highlights the gradual progression to a highly concentrated industry.

One reason for this growth in institutional numbers was a corresponding period of rapid promulgation of legislation, in terms of which different financial institutions were established. While providing a regulatory foundation for these institutions, this created a regulatory landscape with overlapping provisions and low barriers to entry (NRB, 2015). This has resulted in a multitude of institutions operating in the same product market categories. With the introduction of the Bank and Financial Institutions Act (BFI Act, 2006), a superseding umbrella act was implemented for all financial institutions, and provided integrated regulation and control.

The central bank is now focusing on consolidation of BFIs to create a stronger network of banks with wider reach and proliferation.[2]

Large number of financial institutions reducing the possibility of clear market dominance. The FSP landscape in Nepal is highly concentrated. Because of the sheer number of institutions, no single player has been able to gain the dominant market share. Table 19 summarises the major providers of financial services in Nepal.

Phenomenal growth in BFI and significant growth in SACCO numbers. Since 2000 there has been phenomenal growth in the number of BFIs due to the low paid-up capital requirement. Likewise, there has been significant growth in the number of SACCOs.

Informal sector providers are local. The informal sector is dominated by localised players: moneylenders, informal village savings groups and *dhukuti* (financial self-help groups functioning as revolving credit associations).

FDI has been constrained. Nepal opened up foreign direct investment (FDI) in the financial services sector while acceding to the World Trade Organization in 2004. Several terms and conditions imposed upon FDI and the bureaucratic red tape in getting approvals have, however, limited the FDI in the financial sectors.

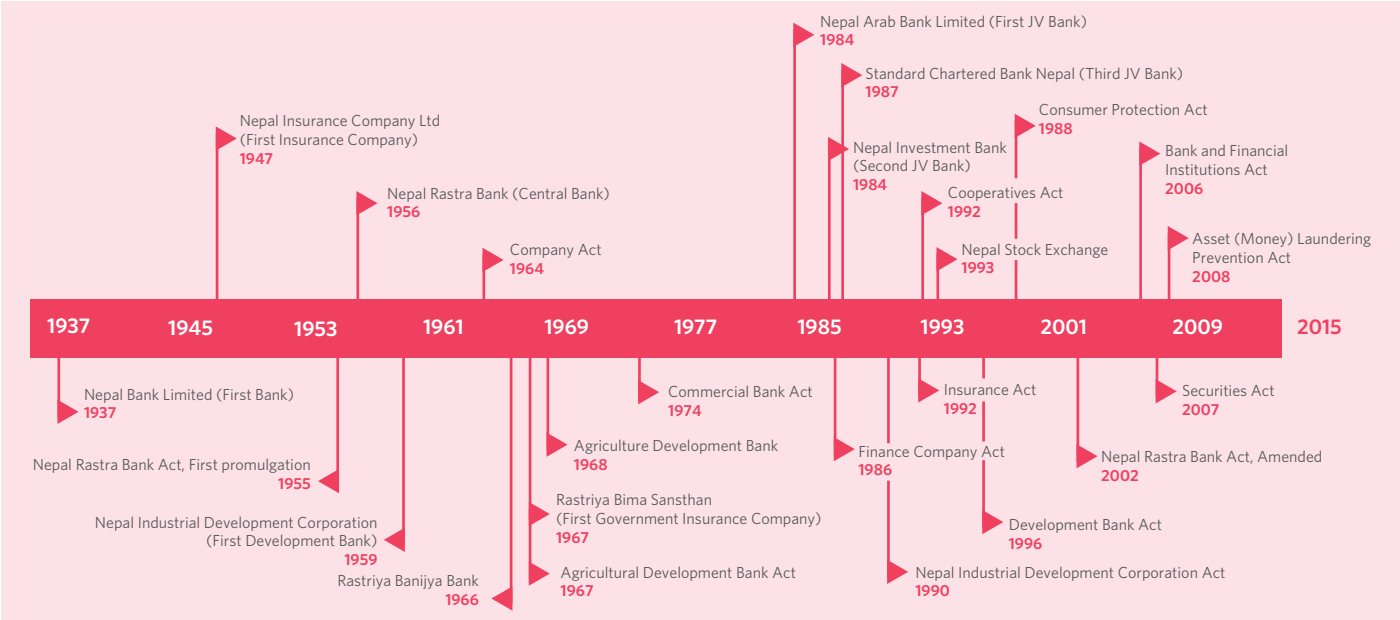


Figure 56: Timeline of entry of key financial institutions and enactment of legislation

Source: Authors' own, based on multiple reports.

Institution type	Number of institutions	Regulation and supervision	Range of services	Targeted market
Commercial banks (class A)	30	NRB	Savings, Credit and Treasury	Formal sector (corporates and institutions) and retail banking
Development banks (class B)	76		Savings and Credit	Formal sector (corporates and institutions) and retail banking
Finance companies (class C)	48		Savings and Credit	Formal sector (corporates and institutions) and retail banking
Microfinance institutions – MFIs (class D)	38		Savings and Credit	Formal/informal sector, micro enterprises, rural and urban households
Financial NGOs (FINGOs)	27		Savings and Credit	Informal sector, micro enterprises, rural and urban households
SACCOs (registered with NRB)	15		Savings and Credit	Informal sector, micro enterprises, rural and urban households
SACCOs (registered with Department of Cooperatives)	13,460	Department of Cooperatives	Savings and Credit	Informal sector, micro enterprises, rural and urban households
Village savings and loan associations	figures unavailable	Registered with village development committees	Savings and Credit	Informal sector, rural and urban households
Employees Provident Fund	1	Ministry of Finance – established under Employees Provident Fund Act 2019 (1962)	Savings, Credit, Insurance	Public and private sector organisations, institutions
Citizen Investment Trust	1	Ministry of Finance – established under Citizen Investment Trust Act (1990)	Savings, Credit, Insurance	Public and private sector organisations, institutions

Table 19: Major providers of financial services in Nepal (as at mid-October 2015)

Banking sector undergoing restructuring. A new requirement for banks and finance companies (classes A, B, C and D) is that capital levels must be increased as laid out in the Monetary Policy (NRB, 2015). With the introduction of this requirement, the sector has seen major restructuring and consolidation, particularly through mergers and acquisitions, and BFI numbers are being significantly reduced in the process.

Banks dominate in terms of total assets and liabilities. More than 92% of the total assets/liabilities of the formal financial system are taken up by banks, while 8% is taken up by other formal providers. Importantly, however, this does not include SACCOs, as the assets for the majority of the financial cooperatives sector are unknown.

The composition of the total liabilities is:
- Dominated by deposits held (80.01%).
- Followed by other liabilities (11.11%).
- Capital fund (7.90%).
- Borrowings (0.99%).

On the assets side:
- Loans and advances account for the largest share (60.60%).
- Followed by liquid funds (17.28%).
- Investments (12.73%).
- Other (9.39%).

Locally based FSPs dominate by market share of clients. MFIs and financial cooperatives (SACCOs) – both of which tend to focus on serving only their immediate local community – are widespread, representing a key component of the 'other formal' provider channel in the FinScope survey. This provider base serves 42% of adults overall, and 23% and 9% of adults with savings and credit, respectively.

Business models are not structured to drive financial inclusion. Most of the banks in Nepal are promoted by big business houses, which are capable of bringing in captive businesses. An NRB rule prevents promoters from making credit available from their own promoted banks. The banking industry is seen as one of the most lucrative sectors for investment and has been providing consistent returns even during the Maoist conflict and political turmoil. The same is evident from the dominance of banking industry scrips in the stock exchange. The average dividend pay-out of the private commercial banks in FY 2014/15 was 24.15%.

Banks not incentivised to go downmarket. Banks that are currently booking comfortable profits are not really incentivised to go downmarket or take additional risk, mainly because of the administrative costs associated with this and a consideration of the anticipated gains against the risks taken. This reluctance on the part of banks has been a key driver behind NRB's

introduction of deprived sector lending, in terms of which the class A, B and C banks are required to allocate specified percentages of their loan portfolio to deprived sector lending. They are permitted to choose between retail and wholesale lending, and most opt for low-cost wholesale credit to the locally based MFIs. Nonetheless, given that the banks have to comply with this requirement, they do not feel obligated to go downmarket as they are already facilitating financial inclusion.

Provider overview

This section discusses each of the major FSPs – formal and informal – and scopes their willingness and ability to provide financial services.

Banks

The term 'banks' in Nepal covers four different categories of institutions – termed class A, B, C and D by the central bank as per the BFI Act (2006). The distinction between the classes is primarily based on minimum paid-up capital; besides this, different classes are subject to different regulations:

- Class A are **commercial banks**: national-level banks with a minimum paid-up capital requirement of NPR 2 billion (US$ 20.28 million).

  However, recent monetary policy (2015/16) requires commercial banks by 2017 to maintain four times the current cap. In addition, commercial banks must maintain a capital adequacy ratio of 6% on core capital and 10% on their capital fund, while complying with the capital adequacy framework of 2007.

- Class B are **development banks**: they are categorised into national, regional (4–10 district coverage) and district (1–3 district coverage) levels, with a minimum paid-up capital requirement of NPR 640 million (US$ 6.49 million), NPR 200 million (US$ 2.02 million) and NPR 100 million (US$ 1.01 million), respectively.

  As with the commercial banks, the monetary policy 2015/16 has from 2017 increased the minimum paid-up capital to four times for national and district level, and six times for regional-level development banks.

- Class C are **finance companies**: they are also categorised into national, regional and district levels. The current minimum paid-up capital limit figures are NPR 200 million (US$ 2.02 million) for the first two levels, and NPR 100 million (US$ 1.01 million) for the district level.

  By 2017 the limit will be increased to four times those figures. Unlike commercial banks, the finance companies and the development banks do not have to comply with the capital adequacy framework, and have a lower minimum capital adequacy ratio on core capital at 5.5%; although the requirement on the capital fund is marginally higher (11%).

- Class D banks are **microfinance banks (MFIs)**: categorised into national, regional and district levels and required to maintain a minimum paid-up capital limit of NPR 60 million (US$ 608,519), NPR 20 million (US$ 202,839), and NPR 10 million (US$ 101,419) on national, regional and district levels, respectively.

  Regarding the source of funds for MFIs, the trend seems to be that class A, B and C banks offer MFIs credit as a part of the banks' deprived sector lending. Currently, MFIs are entitled to provide up to NPR 200,000 (US$ 2,028) non-collateral-based loans and NPR 500,000 (US$ 5,070) collateral-based loans; however, there have been proposals to increase the limit to NPR 300,000 (US$3,042) and NPR 700,000 (US$ 7,099), respectively.

  Note: In this study, class A, B and C financial institutions have been grouped into 'banks category 1' because they provide similar products and service, while class D institutions are grouped under 'banks category 2', which is a bank category

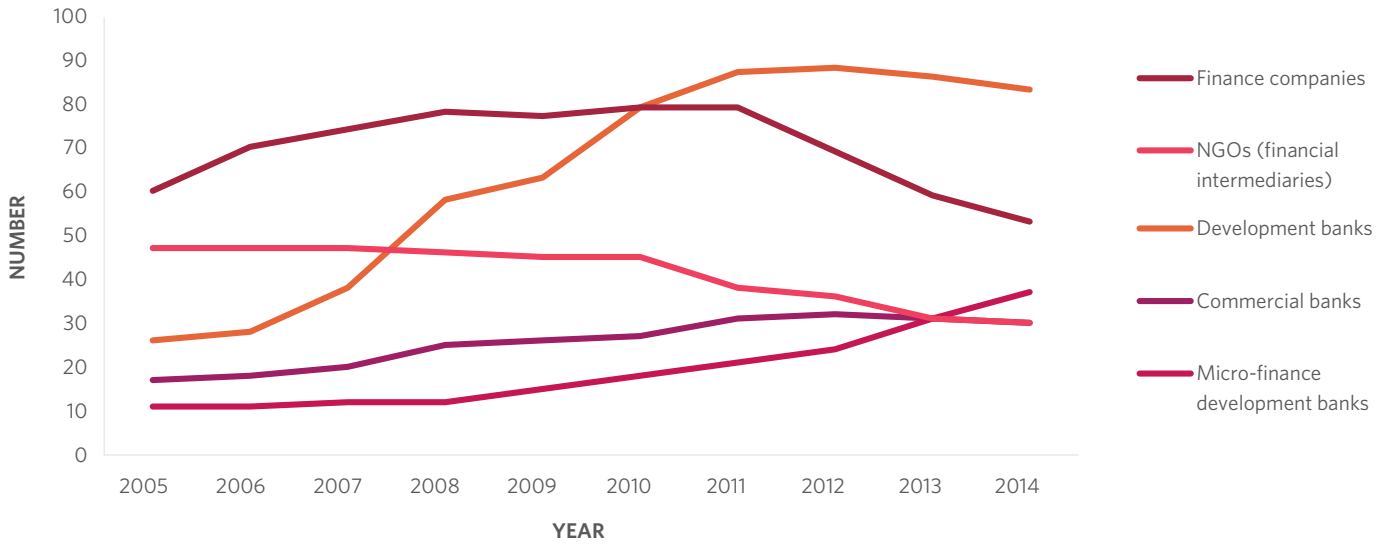


Figure 57: Growth of financial institutions in Nepal

Source: NRB, 2015.

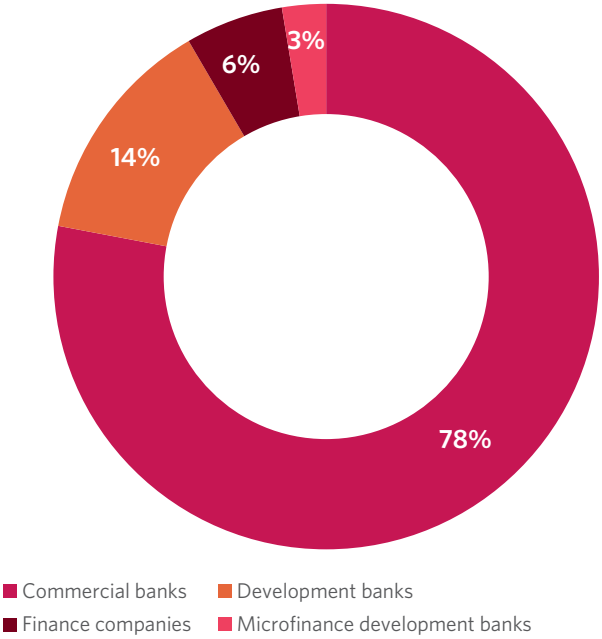


Figure 58: Total assets structure of financial system

Source: Nepal Rastra Bank, July 2014 (Banking and Financial Statistics).

with more specialised focus. Thus, this report also refers to 'banks' and 'MFIs' for category 1 and category 2 institutional groupings respectively. Figure 61 provides an overview of the prevalence of these institutions over the period 2005–14.

As mentioned, post-2010, NRB has been working on the consolidation of the BFIs to strengthen the capital base of the banking system, ensure financial stability and curb the number of BFIs. With the implementation of the new capital requirement, the BFIs have had no option but to go for mergers and acquisitions in order to comply, which has succeeded in bringing down the number of banks. By the same token, the increase in the number of MFIs can be attributed to NRB's policy on deprived sector lending and the conversion of FINGOs into MFIs to promote financial inclusion and increase financial access in remote and rural centres.

Commercial banks have the biggest market share by a large margin. Table 20 shows that commercial banks are the largest mobiliser of deposits and loans in the market. At the end of FY 2013/14, commercial banks mobilised 80.7% of total deposits and 74.6% of total loans.

		2009/10	2010/11	2011/12	2012/13	2013/14
Total assets	*In NPR billions*	996.1	1,158.3	1,380.5	1,584.9	1,889.8
Total deposits	*In NPR billions*	795.3	871.9	1,076.6	1,271.5	1,482
Market share						
Commercial banks	*In %*	79.4	78.9	80.6	80.3	80.7
Development banks	*In %*	9.7	11.1	11.8	12.6	13.5
Finance companies	*In %*	10.0	9.8	7.1	5.4	4.9
Others (includes class D banks, SACCOs and FINGOs licensed by NRB)	*In %*	0.9	0.2	0.5	1.7	0.9
Total loans and advances	*In NPR billions*	622.6	713.1	804.5	983.8	1,066.9
Market share						
Commercial banks	*In %*	74.2	74.0	77.4	76.1	74.6
Development banks	*In %*	10.6	12.5	12.5	13.3	15.6
Finance companies	*In %*	12.8	12.2	8.3	6.7	6.5
Others (includes class D banks, SACCOs and FINGOs licensed by NRB)	*In %*	2.4	1.3	1.8	3.9	3.2

Table 20: Major indicators of BFIs

Source: Ministry of Finance, 2014/15 (Economic Survey).

Development banks are the second largest player in terms of market share, mobilising 13.5% of total deposits and 15.6% of total loans.

The market share of finance companies continues to decrease, as they mobilise 4.9% of total deposits and 6.5% of total loans.

The Others group (which includes class D banks, SACCOs and FINGOs licensed by NRB) holds a marginal market share of 0.9% in terms of deposit and 3.2% in terms of total loans.

The total assets mobilised by these institutions have almost doubled over the past five years to reach NPR 1,889.8 billion (US$ 19.17 billion).

Majority of banks deriving profit from focus at the upper end of the market and are urban based. Commercial banks, the majority of the banking market, are currently highly profitable, with low levels of non-performing loans (NPLs).

The category 1 banks are largely focused on the upper end of the retail market and the corporate market, with development banks as the main mass market retail touchpoint for this group (Nepal Rastra Bank, 2014).

Category 2 banks (the class D MFIs), on the other hand, are mainly focused on niche market retail and MSMEs (Sharma, n.d.).

While one class of banking institution is serving a mass market focus, the question remains whether there is sufficient incentive for all institutions to move to a broader focus, particularly if this includes extending into a market with more opaque credit information and potentially higher risk. Despite the central bank's efforts to encourage banks to open branches in rural areas, in order to bring unbanked people to the banking system, larger chunk of banking services are still concentrated in urban areas and market centres.

Class A financial institutions (commercial banks)

Most commercial banks privately owned. Commercial banks are classified as class A institutions and fall under the BFI Act (2006). These banks can be categorised into two groups – public and private banks – on the basis of ownership and control. Of the 30 commercial banks:

- 3 are public banks.[3]
- 27 are private banks.

In addition, there are currently 6 commercial banks with foreign investment (Nepal Rastra Bank, 2014).

Profitable banking industry. All commercial banks earned profit during the research period except Grand Bank Nepal Limited and Kist Bank Limited, which incurred losses of NPR 1.61 billion (US$ 16.34 million) and NPR 0.30 billion (US$ 3.04 million) respectively.[4]

The net profit of commercial banks increased by 4% to NPR 19.85 billion (US$ 201 million) in FY 2013/14 compared to growth of 29.29% in the previous fiscal year. The decrease in the spread rate and net loss incurred by two commercial banks has contributed to the decrease in the growth rate.

Of the total net profit: 77.44% was reported by the private banks; and the balance by the public banks.

The return on equity (RoE) of the commercial banks averaged approximately 15%, with some banks such as Nabil Bank Limited, Nepal Investment Bank Limited and Standard Chartered Bank having ROE above 20%.

Comfortable liquidity position. Commercial banks' total liquid assets are considered to comprise: their cash balance, their bank balance with NRB and other banks and financial institutions, money on call, and investment in government securities.

The proportion of liquid assets to total assets of the commercial banks in mid-July 2014 was 27.35%. As things stand, commercial banks are required to maintain a statutory liquidity ratio of 12% and a cash reserve ratio of 6% (Nepal Rastra Bank, 2014). Therefore, the commercial banks in Nepal are in a comfortable liquidity position.

One reason for this is that, as a result of the 2015 earthquake, and the unofficial blockade and unrest in the Terai region, the liquidity of the commercial banks has swollen, with the liquidity surplus estimated at above NPR 100 billion (US$ 1.01 billion) (Shrestha, 2015). In previous years the liquidity ratio has averaged 29.48% (2012/13).

Income from on-lending a key revenue driver. The total income of commercial banks increased by 9.85% during FY 2013/14 to NPR 111.72 billion (US$ 1.13 billion): 86% was derived from interest income, and 14% from fees and commission. Due to the higher spread between interest charged on loan products and deposits, the banks' net interest income increased.

Class B financial institutions (development banks)

Declining numbers of institutions. Development banks emerged as class B financial institutions under the Development Bank Act (1995), and saw rapid growth to 88 institutions in 2012 (the highest number to date). At present there are 76 development banks, with some at national level and most at district level (Nepal Rastra Bank, 2014). The number of development banks is declining due to mergers, the halt on issuing new licences and the advancement and upgrade of development banks to commercial banks (*The Rising Nepal*, n.d.).

Development banks profitable and solvent. The MAP research found that the net profit of development banks stood at NPR 3.6 billion (US$ 36.53 million) with an RoE of 14%.

- The average statutory liquidity ratio of development bank: 18.85% (double the regulatory requirement of 9%).
- The capital fund of development banks increased to NPR 31 billion (US$ 314.82 million) from NPR 26.75 billion (US$ 271.5 million) in 2012/13.

- The capital adequacy ratio: 14.08% for core capital (required benchmark is 5.5%); and 15.61% for capital fund (required benchmark is 11%).

Development banks held 13.7% of the total assets of the Nepali banking industry:

- Total assets as well as total liabilities of development banks in FY 2013/14: NPR 242.26 billion (US$ 2.5 billion).
- The major portion of the assets is covered by loans and advances, which comprise 65.86% of total assets – i.e. NPR 159.55 billion (US$ 1.62 billion) – followed by cash and bank balance, comprising 28.17 % of total assets. Investment and fixed assets have a negligible contribution (2% and 1.72 % respectively).
- The major portion of total liabilities is covered by deposits, accounting for 79.23% – i.e. NPR 196.87 billion (US$ 1.99 billion) – while the capital fund contributed 12.80% – i.e. NPR 31.02 billion (US$ 31.8 million).

Business drivers. Interest income was found to be the major source of revenue; the development banks generated almost NPR 9 billion (US$ 91.34 million) in interest income, owing to an increase in the interest spread rate (Nepal Rastra Bank, 2014).

Development banks mobilised the deposit of NPR 199.9 billion (US$ 2.02 billion) and facilitated credit worth NPR 161.8 billion (US$ 1.64 billion) (Nepal Rastra Bank, 2014).

Development banks closely mirror commercial banks, with similar services and products, except those limited by the regulator (limited products include hypothecation).

Also, because of more liberal compliance requirements compared to commercial banks, development banks are preferred by the segment that cannot access loans from the commercial banks but can afford to pay a higher risk premium for these loans (Beed, 2016). The loan portfolio of development banks is diversified in different economic group banks, with higher concentration in the wholesaler and retailer sectors at 18.31%, followed by the construction sector (12.06%) and increasing portfolio in the agriculture and forestry sector.

Deposits accounted for 79.23% of the total liabilities of development banks, amounting to NPR 196.87 billion (US$ 1.99 billion). The total deposit of the development banks increased by 22.85% from the previous fiscal year (Nepal Rastra Bank, 2014).

Development banks concentrated in major urban areas. Despite NRB's efforts to increase financial access and inclusion, there are very few branches of BFIs in specified least-branched districts. As of mid-April 2015, the total number of development bank branches stood at 797 (Nepal Rastra Bank, 2014). Although the numbers of branches of development banks are increasing each year, a major chunk of them are concentrated in urban areas.[5]

Class C institutions (finance companies)

Declining numbers of institutions. Finance companies are classified as class C institutions and fall under the BFI Act (2006). Figure 57 illustrates the rapid decline in the number of these institutions in recent years. The main reason for this is mergers and acquisitions.[6] The total number of finance companies stood at 48 in mid-July 2014 (Nepal Rastra Bank, 2014).

Profitability and solvency. Capital fund of finance companies in 2013/14 was NPR 10 billion (US$ 101.49 million), and NPR 12 billion (US$ 121.799 million) in 2012/13 (Nepal Rastra Bank, 2014). The decrease in the capital fund in the review period can be attributed to a decrease in the numbers of finance companies and a sharp decrease in retained earnings in the same period. The net profit of finance companies in 2013/14 was NPR 1.92 billion (US$ 19.5 million), which was a 71.54% increment from the previous fiscal year (Nepal Rastra Bank, 2014).

Finance companies losing steam. Interest income is the key income driver for finance companies. In FY 2013/14, interest income contributed 80% of the total operating income (Nepal Rastra Bank, 2013/14). There has been negative growth of deposits and credits in finance companies, primarily due to the merger and acquisition of these companies with development banks and commercial banks. However, finance companies remain stable, with a loan-to-deposit (LTD) ratio of 90% – a healthy margin above the prescribed limit of 80% (Nepal Rastra Bank, 2014).

	End of FY 2013/14	End of FY 2012/13
Aggregate deposits	NPR 68.37 billion (US$ 694 million)	NPR 76.80 billion (US$ 779.5 million)
Total loan portfolio	NPR 58.40 billion (US$ 556 million)	NPR 71.59 billion (US$ 726.58 million)

Table 21: Finance companies – deposits, credit (2013/14 vs 2012/13)
Source: Nepal Rastra Bank, 2014.

Finance company revenue streams at risk. The risk attached to the loan books of category 1 institutions (as shown by their NPL percentages) increases as one moves from commercial banks to development banks and finally down to finance companies. By the indicators shown in Table 22, the first two institutions are sitting at healthy levels while finance companies are at a risky level. (However, there is a practice of rolling over loans in the market; therefore, the NPL indicators could be understated, as bad debt is rolled into what appears to be healthy loans.) Recently, NPLs of finance companies have climbed from a dip in mid-2014 to a high of 14.9% of total loan and advances.

	Mid-July 2013	Mid-July 2014	Mid-April 2015
	NPLs as % of total loans and advances		
Commercial banks	2.6	2.9	2.9
Development banks	4.5	4.2	4.0
Finance companies	16.0	13.7	14.9

Table 22: Non-performing loans (NPLs) of category 1 banks
Source: Ministry of Finance, 2014/15 (Economic Survey).

Class D banks (MFIs), SACCOs and FINGOs

Range of MFI-type institutions that are rapidly growing in number. Microfinance development banks are classified as class D institutions and fall under the BFI Act (2006). Currently there are 40 class D microfinance development banks and 27 financial intermediary non-government organisations (FINGOs) under the purview of the central bank (Nepal Rastra Bank, 2014). These institutions are specifically designed to provide services to the country's poor and deprived communities.

The social mandate of the MFIs, which can be based at the national, regional or district level, is to serve those at the bottom of the income pyramid and for this reason these institutions are entitled to low-cost wholesale funds from class A and B banks under the deprived sector lending directive.

Under microfinance development banks there are (Nepal Rastra Bank, 2015):

- 5 Grameen Bikas Banks (now known as Nepal Grameen Bikas Bank Limited – GBB – after merger).
- 30 private sector microfinance development banks replicating the 'Grameen banking model'.
- 3 wholesale lending microfinance financial institutions.

These institutions have seen rapid growth over the past five years (see Figure 57).

MFIs' ability to access remote areas limited. Microfinance is mostly concentrated in the Terai region and certain urban centres of Nepal. The biggest challenge for this sector would be to provide access to all needy people across Nepal, especially in the hill and mountain regions. Given the country's poor infrastructure, difficult terrain and scattered population, expansion of microfinance in inner areas of hill and mountain regions is still difficult. Although MFIs claim to have reached all the districts, they are located only in the market areas and most of the activities are focused in the urban/peri-urban areas with easy proximity to markets and high population density.

FINGOs transforming into microfinance development banks. NRB has been gradually decreasing the numbers of FINGOs by allowing them to transform into class D microfinance institutions. This step has been taken to improve the regulatory practices in FINGOs and allow them to expand their horizons in terms of expanding and deepening financial assets. As of October 2015, the number of FINGOs was down to 27. The FINGOs collectively held deposits of NPR 11.1 billion (US$ 112.65 million) and a loan book of NPR 35.8 billion (US$ 363.34 million) as of mid-July 2014. They had investments totalling NPR 3 billion (US$ 30.44 million).

Profitable with a growing loan and deposit base. The MAP research found that the overall net profit of the MFIs stood at NPR 1.2 billion (US$ 12.17 million) while their RoE was 21.6%.

	2012/13	2013/14	% change
Total members			
MFIs	1,252,353	1,616,367	29%
GBBs	186,056	191,781	3%
Total assets in NPR millions			
MFIs	35,750	49,092	37%
GBBs	5,573	6,404	15%
Deposits (in NPR millions)			
MFIs	7,225	11,041	53%
GBBs	1,030	1,196	16%
Loans and advances (in NPR millions)			
MFIs	23,392	35,429	51%
GBBs	3,373	3,879	15%

Table 23: Key Indicators of class D banks

Source: Financial Stability Report 2014.

During this period the total loans disbursed by these institutions was NPR 194.4 billion (US$ 1.97 billion) (increased by 37.9%).

Table 23 highlights some of the key indicators of class D banks. The table shows an increase in the total number of members in both microfinance development banks and GBBs.

In terms of MFIs' revenue, 90% is driven by interest-based income (this figure is based on annual reports of microfinance companies listed on NEPSE for the year 2013/14); as part of this, the saving deposit mobilisation of MFIs increased by 52.9% to NPR 11.0 billion (US$ 111.64 million).

Compared to total liabilities of these institutions, the share of deposit mobilisation remained at 22.5%.

Of total deposits, 36.7% was compulsory deposits. The total borrowing of MFIs increased by 37.2% to NPR 27.7 billion.

NPL under control. Non-performing loans of MFIs remained at 1.2% during the MAP research period, which is within the regulatory acceptable range of 5%, a fact that further signifies the low level of risk these institutions hold.

Access to funds at lower rates. Microfinance development banks licensed by NRB enjoy access to funds possibly at lower rates compared to normal market rates, largely due to NRB's mandatory provision for deprived sector lending; BFIs licensed by NRB fulfil the mandatory deprived sector lending requirement through either individual lending or wholesale lending to class D institutions or to SACCOs (the latter – wholesale lending – is BFIs' preferred option). Currently, class A commercial banks are required to disburse 5%, class B development banks 4.5% and finance companies 4% of their total outstanding loans and advances in the deprived sector.

Savings and credit cooperatives (SACCOs) under the Department of Cooperatives (DoC) purview. The Cooperative Act (1992) governs the formation, registration, membership and working procedures of SACCOs that are registered with and thus under the purview of the Department of Cooperatives. In Nepal, there are generally three types of cooperatives:

- SACCOs are formed to take deposits from and provide credit to their members.
- Specific-purpose cooperatives aid in specific activities such as agriculture, dairy, electricity etc.
- Multi-purpose cooperatives are formed to conduct more than one activity. Most multi-purpose cooperatives in Nepal also conduct saving and credit activities.

Therefore, saving and credit cooperatives and multi-purpose cooperatives can be classed together and termed 'financial cooperatives'.

The Department of Cooperatives estimates that there are a total of 32,663 cooperatives (financial and other) operating across the country. Saving and credit cooperatives (SACCOs) alone number 13,460, and when multi-purpose cooperatives are taken into account, the total number of financial cooperatives rises to 17,491 (Department of Cooperatives, 2015). The financial cooperatives have a significant presence in rural areas, providing direct employment to 54,143 people, while further employment through indirect means such as micro-entrepreneurship remains unaccounted.

SACCOs under NRB purview. While the majority of financial cooperatives, as explained above, are registered under the Department of Cooperatives (Ministry of Cooperatives and Poverty Alleviation), there are a few financial cooperatives licensed by NRB; in the 1990s, NRB licensed some cooperatives to carry out limited banking functions. As of mid-July 2014, 15 cooperatives were carrying out limited banking activities. Among these, the National Cooperative Development Bank (NCDB) is licensed for wholesale business. Total deposits of these cooperatives had increased by 39.2 % to NPR 15.9 billion (US$ 161.37 million) by mid-July 2014, and loans and advances had increased by 25.0 % to NPR 11.8 billion (US$ 119.76 million). The total capital fund had increased by 19.1% to NPR 1.4 billion (US$ 14.21 million) in 2013/14 (Nepal Rastra Bank, 2014).

SACCOs/financial cooperatives are key formal sector providers. On the financial front, financial cooperatives – which are locally based and locally owned providers – account for around 10% of total deposit and credit of NRB-regulated financial institutions (as per data of mid-July 2014).

In terms of client numbers, SACCOs or the financial cooperatives are the second placed priority formal providers, after banks,

				In NPR millions			
	Numbers	Members	Promoters	Shareholder's Fund	Deposit	Credit	Investments
Financial cooperatives (SACCOs and multi-purpose)	17,491	3,793,475	144,813	63,304	186,585	173,155	204
Others	15,172	1,306,895	123,175	6,535	15,836	14,602	103
Total	32,663	5,100,370	267,988	69,839	202,421	187,757	307

Table 24: Key highlights of Nepal's financial cooperatives

Source: Department of Cooperatives, 2015 (Statistics of Cooperative Enterprises).

and have emerged as a major backbone of the financial sector (FinScope, 2014).

Table 24 shows the key highlights of the sector. With more than 5 million members, the ratio of male and female stood at 53.5% and 46.5%, which is highly commendable. Women's participation at the leadership level in cooperatives stood at 33.8%, while the number of all-women operated cooperative institutions has reached 3,656.

Revenue drivers. The primary revenue drivers of these institutions is from lending credit to their members by mobilising members' savings. The high interest rate spread serves as the key revenue driver of cooperatives.

BOX 14: SMALL FARMER AGRICULTURAL COOPERATIVES

An example of SACCOs are the Small Farmer Cooperative Limited (SFCL) institutions and other microfinance institutions of similar nature. They are established and operated by small farmers in the rural sector for operating agriculture and agro-based microfinance programmes and in particular, to make wholesale credit available.

The number of cooperatives that extend microfinance services has reached 478, with 403,666 families having joined cooperatives, and cooperatives thereby benefiting some 2 million people (Ministry of Finance, 2015). Cooperatives' services are available to almost 450,000 families, including members of 138 small-farmer replication programmes; under the small-farmer replication programme, farmers are divided into groups and encouraged to form farmer cooperatives, which are governed and run by the farmers in a democratic fashion to increase economic growth.

In 2015, the credit investment of SFCLs reached NPR 4.65 billion (US$ 47.19 million) and the approved loan amount stood at NPR 4.74 billion (US$ 48.1 million). The loan recovery rate improved by 32% and local capital formation, including shares, savings and reserve fund of small farmer members, reached NPR 10.89 billion (US$ 110.52 million). The sum total of capital mobilised in the SFCL sector stood at NPR 18.06 billion (US$ 183.29 million) (Ministry of Finance, 2015).

Informal providers

Savings groups and informal moneylenders key providers in the informal market. The informal provider sector is characterised by informal groups or associations of people that pool savings funds to extend credit to their members, as well as capital-flush individuals that on-lend to their local community, and individuals that provide informal remittance services. Various informal saving and credit groups, self-help groups, *dhukuti*, local moneylenders and *hundis*, among others, can be grouped in this category.

Since there is no mechanism for registering these sectors/groups, data on their transaction volumes and activities is not available.

In terms of client numbers, these informal providers serve a wide base of the Nepali adult population:

Savings groups (e.g. village savings groups, dhukuti*).* Of the adult population, 31% (4.5 million adults) indicated that they belong to a savings group. Of these adults (FinScope, 2014):

- 91% indicated that this savings group was a village savings group – an informal mechanism whereby local members of a particular locality make regular (often daily) saving contribution to the group.
- 8% indicated a savings group linked to production.
- 2% make use of *dhukuti*.

Of the adult population, 11% (1.8 million) indicated that they receive some form of risk mitigation through the savings group to which they belong.

Moneylenders. The services of individual moneylenders were used by 21% of adults (3.3 million adults) at the time of the FinScope (2014) survey.

Hundis. Almost no adults indicated use of *hundis* (informal MTOs providing cross-border transfer services): only 1% (116,000) of adults use *hundis* to send or receive remittances.

Short-term loans provided by informal providers. The informal providers typically offer loans of shorter term than the formal providers. The term of these loans can be one to two months and the interest rate is usually charged per month or simply on the sum borrowed. The informal moneylenders are typically used in the event of an emergency when customers need cash immediately and there are no alternatives.

In some cases, local merchants or businesses provide trade credit on an informal basis and can also be included in this category. Examples of this are local grocery stores or general dealers offering regular customers credit to buy groceries and other household items, and hardware and building material stores offering credit on such things as bricks, cement and other building supplies.

Informal remittance sent through hundis. The growth of informal channels impacts negatively on the country's foreign exchange earnings and as a result the central bank is attempting to discourage such channels. NRB, in order to curb the informal payment system, has imposed restrictions on Nepali and foreign nationals forbidding them to carry more than NPR 5,000 (US$ 50.75) cash when leaving or entering the country (*Republica*, 2015). The use of *hundis* for remittance sending and receiving was found to be very low.

Dhukuti *a popular informal mechanism.* The *dhukuti* system is an informal association of individuals to provide help to members. It began as a system of storing communal food grain but expanded to become an informal people's bank. It functions on the basis of rotating savings and credit, whereby members have a turn-wise access to the total funding pool. The sources of funds of these *dhukuti* are driven from savings mobilised by the members, who contribute at regular intervals. The allocation of funds is determined by a secret tender, with the funds going to the lowest bidder except for the first and last rounds (Seibel,

1988). The *dhukuti* system is prevalent in urban areas among females (Seibel, 1988).

One problem with the *dhukuti* system is the ability for more and more people placing bids of unreasonably low amounts to capture the fund immediately and speculate on exceptionally high returns on their investment. When these expectations fell through, there are examples of member that found themselves unable to abide by their obligations and dropped out of the *dhukuti* before its conclusion (Seibel, 1988).

Village savings groups. Village savings groups are informal savings groups prevalent mostly in rural areas. A village savings group is a self-selected group of people who belong to a particular community. Members pool their money into a fund on a regular basis, often daily. The amount and frequency of contribution is determined by mutual consent among members. Members of the group can borrow from the saving fund, and the money is repaid with interest, causing the fund to grow. Village savings groups fulfil the need for small, local pools of capital to satisfy households' cash management needs. They provide immediately sustainable and profitable savings and insurance.

Insurance companies

Large but static insurance industry. The Insurance Act (1992) currently governs the insurance sector, and the Insurance Board (IB) of Nepal is the sole authority to regulate the insurance activities in Nepal. Insurance institutions can either provide life or non-life products (i.e. no composite insurers are allowed).

Unlike the banking sector, the insurance sector in Nepal is still in its infancy, with a formal sector market penetration rate of only 11% of adults (FinScope, 2014).

As shown in Table 25, there are 17 non-life insurance companies and 9 life insurance companies currently operating in Nepal. Of this pool of companies, one non-life and one life insurance company are government-owned entities, while three are operating as branches of foreign insurance companies. There is also one local reinsurance company (Nepal Reinsurance Company Ltd), which was established in 2014 to succeed an insurance pool used by market players in lieu of a reinsurance company.

The life and non-life insurance provider landscape has remained relatively unchanged in recent years:

- The most recent life insurance company to be set up was in 2008. Prior to 2000, only Rastriya Beema Sansthan and National Life Insurance Company Ltd served the life insurance segment.
- The non-life insurance market has not seen new entrants since 2005, when three companies were established (Beema Samiti, 2012).

Life insurance market dominated by three players. Life Insurance Corporation (Nepal) Limited, Nepal Life Insurance Company Ltd and Rastriya Beema Sansthan (RBS), and National Life Insurance Company Ltd dominate Nepal's life insurance market.

Jointly, the three players accounted for over 71% of the life insurance market by premiums in 2013/14 (as shown in Figure 59). (Note that the figure does not include the figures for Rastriya Beema Sansthan due to unavailability of data for the review period.)

Non-life insurance market is more competitive across a greater number of insurance providers. As shown in Figure 60, unlike the life insurance market, the non-life insurance provider landscape is dispersed across a large number of the market players.

Life insurance	Non-life insurance	Reinsurance
Rastriya Beema Sansthan	Nepal Insurance Company Ltd	Nepal Reinsurance Company Ltd
National Life Insurance Company Ltd	The Oriental Insurance Company Ltd	
Nepal Life Insurance Company Ltd	National Insurance Company Ltd	
Life Insurance Corporation (Nepal) Ltd	Himalayan General Insurance Company Ltd	
American Life Insurance Company Ltd	United Insurance Company (Nepal) Ltd	
Asian Life Insurance Company Ltd	Premier Insurance Company (Nepal) Ltd	
Gurans Life Insurance Company Ltd	Everest Insurance Company Ltd	
Surya Life Insurance Company Ltd	Neco Insurance Ltd	
Prime Life Insurance Company Ltd	Sagarmatha Insurance Company Ltd	
	Alliance Insurance Company Ltd (now renamed Prabhu Insurance)	
	NB Insurance Company Ltd	
	Prudential Insurance Company Ltd	
	Shikhar Insurance Company Ltd	
	Lumbini General Insurance Company Ltd	
	NLG Insurance Company Ltd	
	Siddartha Insurance Ltd	
	Nepal Beema Company	

Table 25: Insurance companies in Nepal

Source: Insurance Board, 2014.

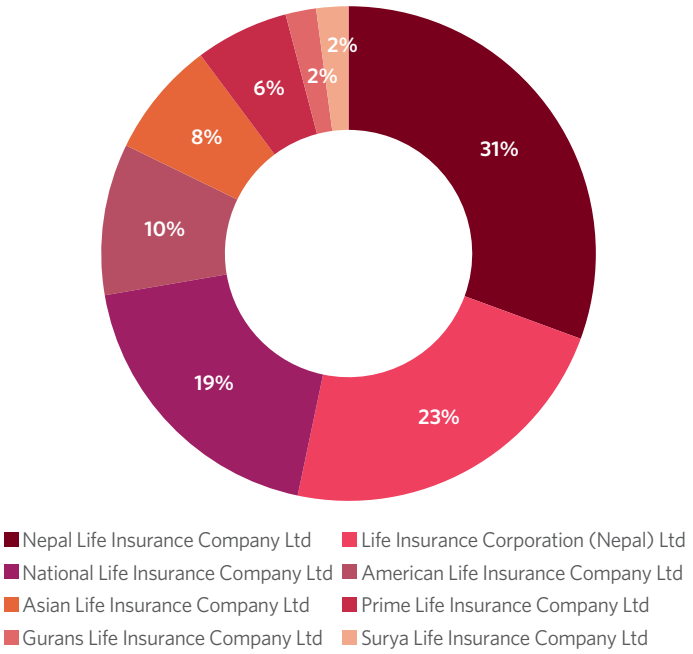


Figure 59: Market share by premium, life insurers in 2013/14
Source: Authors' own from annual reports of life insurance companies; Beema Samiti, 2013/14.

In 2009/10, Rastriya Beema Sansthan, National Insurance Company Ltd and Sagarmatha Insurance Company Ltd held 31% of the market in terms of premium. (Note that Figure 60 does not include the figures for Nepal Beema Company and Everest Insurance Company Ltd due to unavailability of data.)

Nepal's first reinsurance company established. With the slow development of the insurance industry in Nepal, there has been a strong need for a national reinsurance company. The lack of domestic reinsurance companies in the past had made providing insurance expensive for service providers. Initially an insurance pool was created in 2003 with 50% equity participation from the Government of Nepal, non-life insurance companies and others for policy compensation backup. This pool was formally converted into the Nepal Reinsurance Company Ltd on 7 November 2014, with the company acting as the pool manager and reinsurer.

The reinsurance company currently has a paid-up capital of NPR 5 billion (US$ 50.74 million). The establishment of a reinsurance company in Nepal is expected to curb massive fund outflows for reinsurance purposes (Khanal, 2014).

Insurance companies witnessing steady growth in premiums, despite variable profitability in the life sector. Both life and non-life insurance industry business models are primarily driven by the sale and administration of insurance products, and both types of company have experienced positive growth in premiums over the five years to 2014. This was particularly pronounced for life insurance companies, with an average year-on-year growth in premiums of 24% (compared to non-life's average growth of 26% over the period). However, the life insurance industry's profitability trend has not tracked this premium growth, with steadily rising profitability until 2012 but then a drop of 35% to 2013 and only marginally recovering in 2014. The profitability of life insurance companies rises every three years, largely because actuary valuation is done every three years. The non-life insurance industry has seen steady growth in profitability over the five-year period, with a spike of growth worth noting between 2013 and 2014. The valuation of non-life insurance is done on a yearly basis.

In NPR million	2009/10	2010/11	2011/12	2012/13	2013/14
Premium collection					
Life	8,766	10,449	13,361	15,884	19,717
Non-life	6,496	7,171	7,283	8,345	10,564
Total	15,262	17,620	20,644	24,229	30,281
Net profit					
Life	195	223	1231	909	938
Non-life	565	656	835	845	1,460
Total	760	879	2,066	1,754	2,398

Table 26: Profitability and premium collection of insurance companies (2009/10–2013/14)
Source: Insurance Board, 2014.[7]

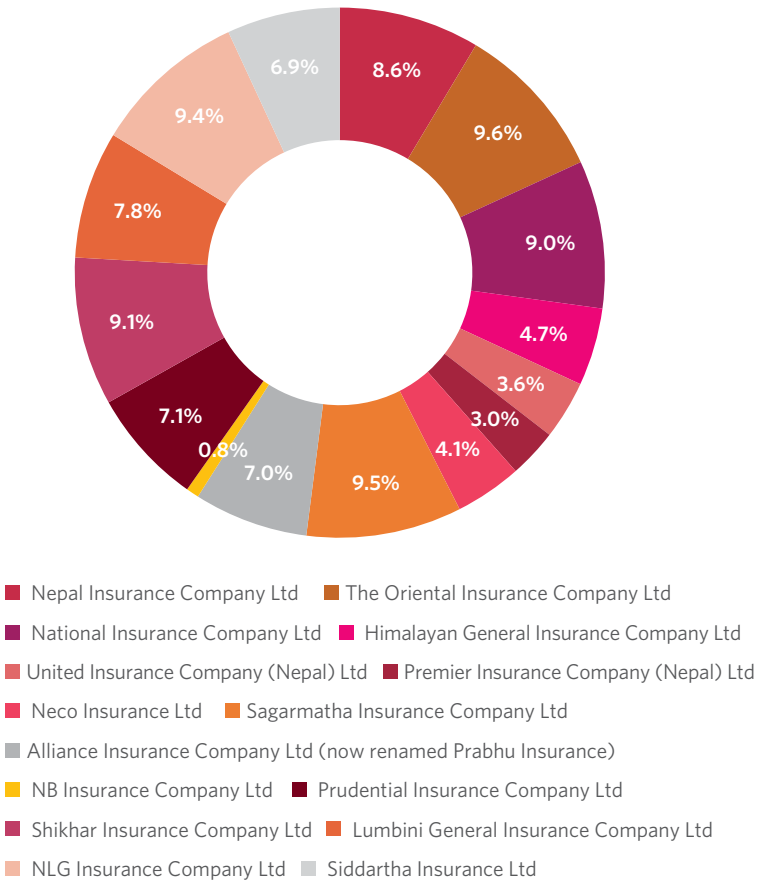


Figure 60: Market share by premium non-life insurers in 2013/14
Source: Beema Samiti, 2013/14.

No. of policies issued	2009/10	2010/11	2011/12	2012/13	2013/14
Life	718	768	911	1,025	1,218
Non-life	476	569	718	810	917
Total	1,194	1,337	1,629	1,835	2,135

Table 27: Number of policies issued by life and non-life insurance companies (2009/10–2013/14)

Source: Insurance Board, 2014.

Insurance sector growing. One reason for the growth in premiums has been an increase in the number of policies issued. Table 27 shows the growth trend of policies issued by both life and non-life insurance companies over the past five years. The overall insurance industry has seen an average year-on-year growth of 15.6%, while the non-life insurance sector has seen a slightly higher growth of 17.8% compared to the 15.6% growth of life insurance companies.

New insurance act likely to change the institutional landscape. A draft bill in under review at the Ministry of Finance, and once approved it will replace the existing Insurance Act (1992). A key feature of the new legislation is the upward revision in paid-up capital: by 900% for life insurance companies and 1,500% for non-life insurance companies. According to the draft bill, insurance companies will have to increase their capital within two years of the bill coming into effect. This increases the level of risk provisioning that the companies are required to do, which will tie up capital previously available for day-to-day operations, and is likely to negatively impact on profitability unless market penetration is increased.

Insurance sector lacks infrastructure. One of the primary obstacles to the growth of the insurance sector in Nepal is the unavailability of adequate infrastructure, namely sufficient distribution channels and appropriate human resources. For instance, with insurance companies there is a barrier to opening physical branches in rural areas due to high operational costs. This results in a high dependence on the agent model, whereby agents become the interaction point with all rural customers (Nepal, 2012). The experiences recounted in the qualitative study (2015) indicate that these agents are often neither well educated nor professional. They often have only a limited understanding of the insurance products and are unable to clearly expound on the importance of taking up insurance in terms of security; rather, they tend to focus on returns or discount rates (MAP qualitative study, 2015). The agency model is also considered unreliable by respondents because of cases of agents not following up on collection of premium over the years. With the nearest insurance office located far away, these customers are often left with no option to but to forfeit their policy.

Retirement funds

In Nepal, there are currently two self-regulated government-owned autonomous institutions under operation that manage retirement funds of employees working at public and private institutions. These institutions are supervised by the Ministry of Finance.

Citizen Investment Trust (CIT) offers a broad portfolio of services at high returns. CIT was established in 1991 under the Citizen Investment Trust Act (1990). The primary focus of CIT is to mobilise individual and institutional deposits for the purpose of long-term savings for retirement. In addition, the Trust provides credits and loans to members on the basis of their deposits and has been working as issue manager to facilitate issuance of shares of various organised institutions (Citizen Investment Trust, n.d.).

CIT has also been the administrating insurance fund programme to more than 365,000 government employees, as per insurance benefits mentioned in the Civil Service Act 2049 (1993). Under the insurance scheme, CIT provides general life insurance for the insured up to the sum of NPR 100,000 for 20 years life.

Deposits (collection of fund) rose by 29% to NPR 59.25 billion (US$ 601.33 million) in mid-March 2015 compared to the same period of the previous year (Citizen Investment Trust, n.d.).

Employees Provident Fund (EPF). EPF was established in 1962 under the Employees Provident Fund Act (1962). It has been managing provident funds of civil servants, military personnel, police personnel, teachers, and personnel of government institutions and some private companies for the purpose of providing long-term savings for retirement. To generate returns on these savings, the Fund has been investing in real-estate business, industry and hydro-power projects.

Further product offerings provided are the ability for members to access credit based on their deposits. EPF also provides the following social security benefits: accident indemnity, funeral grant, and employee welfare scheme (insurance).

The provident fund of depositors had grown to NPR 164 billion (US$ 1.66 billion) in 2013/14, a 16.23% growth on the previous year.

Participation in CIT and EPF schemes. As of mid-July 2015, there were 490,000 participants under various schemes issued by EPF, which are mostly employees of government and public limited companies. And as of mid-July 2015, there were 563,800 participants under various schemes issued by CIT (see Table 28). For the CIT schemes, 161,600 were participating under retirement fund schemes (the majority being employees of private entities), while 367,000 government employees were participating in the Government Employees Insurance Fund.

Retirement funds mainly cover organised sector workers. As per the existing regulations, participation in these retirement funds is compulsory for civil servants and voluntary for any organisation with 10 or more employees. Self-employed people do not have access to these services. The voluntary nature of participation for private sector firms has not translated into a high level of uptake in the funds by this sector. Due to the fact that subscription to the fund is required at the institutional level in order for individuals to access the benefits, the result

Scheme/programme	Participants	
	EPF	CIT
Retirement fund for government employees	382,000	
Retirement fund for public companies	108,000	
Retirement fund for private companies		161,600
Unit scheme		1,700
Pension fund/gratuity fund		22,000
Government Employees Insurance Fund		367,000
Other institutions' employees insurance fund		1,500
Investors account scheme		10,000
Total	**490,000**	**563,800**

Table 28: Number of participants or members associated with retirement funds
Source: EPF, 2016; CIT, 2016.

in the market is a large number of privately employed and self-employed individuals with no access to the fund benefits (Government of Nepal, 1991).

Money transfer operators (MTOs)

Growing proliferation of MTOs. As of 2015, the central bank had provided licences to 50 companies to carry out the function of MTOs (NRB, 2016). The key revenue driver of these institutions is remittance products.

In 2013/14 (*Kathmandu Post*, 2014):

- MTOs accounted for 58% of the incoming remittances, including domestic and cross-border.
- Commercial banks channelled 36% of the incoming remittances, including domestic and cross-border.

The proliferation of MTOs has substantially improved remittance services throughout the country. MTOs partner with FSPs and also assign sub-agents.

However, some MTOs are only provided with restrictive licensing that mandates their operation exclusively through banks (Pant, n.d.).

Mobile financial service providers (MFSPs)

MFSPs are privately owned. The mobile financial service providers (MFSPs) in Nepal are led neither by banks nor mobile network providers, who do not have any direct involvement. MFSPs in Nepal are privately owned and privately operated companies working in conjunction with banks.

Central bank currently has limited influence over MFSPs. MFSPs do not fall within the direct jurisdiction of the central bank. However, the central bank is mulling the option of issuing guidelines on licensing of payment gateways, which would effectively bring the activities of such institutions under its domain.

Limited interoperability. The MFSPs operate independently in a closed-loop system, connecting only to the FSP within their network. The result is little to no interoperability between MFSPs. This limits their usefulness to consumers and has resulted in lower usage and adoption of the technology.

Interoperability is key to the expansion of users and usage opportunities and hence to the sustainability of a country's payment ecosystem, in which mobile financial service providers can play a crucial role.

Splitting the banking market. The lack of regulatory control on the part of the central bank over MFSPs has created an environment of unbalanced and ineffective competition; new MFSPs, in their closed-loop systems, are not expanding usage and usage opportunities but rather further subdividing the banking market even as it is undergoing consolidation.

Unreliable telecoms system a further obstacle. An additional challenge is that the telecommunication system is unreliable in the sense that system up-time is limited. This has reduced trust in MFSPs, further discouraging uptake of mobile financial services.

MFSPs venturing into agreements with businesses and government. Some MFSPs (e.g. Hello Paisa) have entered into agreements with Nimbus Holding to facilitate the business of Nimbus in rural areas, which includes collaboration with over 500 dealers and sub-dealers. Hello Paisa operators will act as customer touchpoints for the Nimbus distribution network. Similarly, when the April 2015 earthquake occurred, Hello Paisa aided in distributing cash to earthquake-affected victims.

Financial service infrastructure

Financial institutions often do not operate in isolation and require supporting infrastructure to effectively run their businesses. For example, these institutions need access to capital, support with day-to-day needs and channels through which to distribute their products. These channels can be provided by the institutions themselves or traditionally connected distribution channels (considered the traditional channel) or by new, third-party institutions (considered the alternative channel).

This section focuses in on two financial services infrastructure components, namely: capital markets and distribution channels.

Capital markets

Capital markets mobilise savings from those with a surplus and allocate them to investment opportunities in the form of debt or equity. An efficient capital market mobilises large volumes of savings and allocates them to the most productive opportunities at the lowest possible cost to both parties (Levine, 1997). At both ends of the intermediation of value chain, this influences the extent to which savings are mobilised and credit is provided through the formal financial sector.

Capital markets gaining momentum. The Nepal Stock Exchange (NEPSE) is the single secondary market in the country. It is regulated by the Securities Board of Nepal (SEBON). The NEPSE opened its trading floor in 1994 and currently has 234 listed companies, which includes commercial banks, hydropower companies, insurance companies, finance companies and others.[8]

The market is dominated by banks and financial institutions, which previously accounted for 90% of the total turnover (NEPSE, 2014). This was driven by a mandatory provision to issue shares to the general public.

Market capitalisation in 2014 was US$ 10.73 billion, which is approximately 54% of the country's GDP (SEBON, 2013/14). Market capitalisation has doubled compared to 2013, implying that capital market value is growing at a good pace. Table 29 shows some of the key indicators of the secondary market.

Capital market attracting large number of participants. The trading volume of the secondary market, which is one of the major indicators of liquidity in the capital market, has seen steady growth over the years, especially since FY 2012/13. In FY 2013/14, the secondary market saw turnover increase significantly (by over 250%) compared to FY 2012/13, amounting to a total transaction of NPR 77 billion (US$ 781 billion). The primary market has seen an overwhelming response from general investors oversubscribing to the initial public offering (IPO) of securities by multiple folds (Share Sansar, 2016). For instance, during the IPO of a local hydropower development company offering, shares worth NPR 2 billion were oversubscribed by 21.58 times, making a whopping collection of over NPR 40 billion from a total of 304,634 applicants (Share Sansar, 2016).

Among the main reasons for uptake of capital markets in Nepal are: electronic clearing and settlement of securities; attractive dividends from listed companies; outreach of stock brokerage companies outside Kathmandu Valley; entry of mutual fund schemes; an increase in awareness levels; key regulatory measures; and lack of investment avenues.

Mandatory pushes are a key driver of listing on the stock exchange. The capital market is not seen as an alternative source of long-term capital in Nepal for most companies in the country (MAP qualitative study, 2015). Only about a tenth of the companies registered with the Office of the Company Registrar are listed on the stock exchange (Shrestha & Subedi, 2014). This is mainly due to stringent compliance requirements for listing on the stock market and onerous reporting requirements, which act as a disincentive, especially evident in the delays in currently listed companies submitting required documentation.[9]

In order to list on NEPSE, companies must submit a wide range of company registration and financial documents for the previous three consecutive years. A provision that allows the premium rate to be up to two-and-a-half times the company's net worth was introduced to encourage more companies to voluntarily enter the capital market. However, the provision is yet to create any significant impact (SEBON). For those listed on the exchange, a large portion are driven by mandatory provisions: as noted above, financial companies that make up the majority of the NEPSE board were mandated to be listed; furthermore, hydropower companies were mandated by the SEBON to issue 10% shares to local people affected by the hydropower project[10] – which has the side benefit of increasing the participation of the rural population in the capital market.

US$ 8 billion of capital mobilised by financial institutions in Nepal. However, despite high demand for investment on the stock exchange, the volume and scope of turnover of other sectors remain nominal. Turnover in FY 2014/15 was NPR 65.53 billion (US$ 665.07 million). There is therefore evidence of buy-and-hold behaviour on the part of the investor base.

Banks and financial institutions, including insurance companies, mobilised US$ 8.3 billion in 2014, which is 77% of the capital ('capital' in this instance refers specifically to financial capital). Hydropower companies contributed 9%, production and manufacturing industries contributed 2% and hotel groups contributed 2% of the total capital mobilisation.

	2009/10	2010/11	2011/12	2012/13	2013/14
NEPSE index	477.73	362.85	389.74	518.33	1036.11
Number of listed companies	176	209	213	230	233
Market capitalisation (in NPR 10 millions)	37,687.00	32,348.00	36,826.00	51,449.00	105,716.00
Total turnover amount (in NPR 10 millions)	1,185.00	666.00	1,027.00	2,204.00	7,721.00
Primary market-capital mobilisation (in NPR 10 millions)	1,082.64	685.40	295.01	1,068.52.00	726.68

Table 29: Key indicators of secondary market (2009/10–2013/14)

Source: Ministry of Finance, 2014/15 (Economic Survey).

The banking sector has been the preferred stocks for customers because banks are making lucrative profits, which is translating into capital gains within short period of time. Moreover, the shares of manufacturing companies are less liquid and highly priced, making this a less lucrative investment area for the average investor (SEBON, 2013/14).

Debt market is underdeveloped. No secondary bond market currently exists. Two main reasons for this are a lack of infrastructure and a lack of skilled human resources to facilitate the market's development. Furthermore, the lack of a scripless securities settlement system or primary dealer have been a key barrier for the development of the bond market. Currently, government Treasury bills are sold on an auction basis. The lack of institutional investment opportunities has resulted in the Treasury bills being oversubscribed regularly (CEMID Nepal, 2012). Buyers of development bonds generally tend to hold them until maturity, a factor that reduces the supply of bonds for a secondary market (CEMID Nepal, 2012).

Regulatory intervention shaping financial institutions' engagement with capital market. Regulatory interventions have played a key role in shaping the capital market in Nepal. The main areas in which this has taken place are the following:

- The promulgation of the Securities Act (2007), which established rules and regulations for stock trading activities; this has provided a conducive environment for the growth of capital markets (Gurung, 2004).
- As noted above, Nepal's legal provision mandates all banking and financial institutions and insurance companies to float public shares. This has resulted in the concentration of banking and insurance scrips on the stock exchange. Furthermore, it permits the operation of competing stock exchanges.
- Nepal's stock market regulation has no provision for the listing of foreign companies and only allows local subsidiaries of foreign companies to be listed.
- In order to promote financial stability and to mobilise the resources needed for long-term growth, NRB has introduced policies that require all categories of BFIs to increase their minimum paid-up capital by mid-July 2017. This directive has caused significant changes in the capital market, since BFIs are opting for mergers to meet the new capital requirement. The capital market is expected to grow in the near future as a direct result of this directive (Khanal, 2015).

Digitisation of shares mandatory. Since August 2015, the NEPSE has made digital transactions mandatory for commercial banks in the secondary market. The target is to fully convert physical records of investment into electronic records. Similarly, digital transactions of other listed companies will be implemented by Central Depository Scheme and Clearing Limited. The implementation of digitisation of shares aims to end problematic issues related to physical trading, including damage to paper certificates and time required to clear physical shares.

No alternative stock exchange board available for MSMEs. The NEPSE is the sole stock exchange platform of Nepal. The lack of alternative exchange makes it a challenge for smaller enterprises to source capital from the stock exchange and therefore access a form of equity financing. The reason that the main exchange is restrictive is due to the high upfront and yearly requirements to remain listed (both in terms of monetary requirements and the level of documentation required). For example, In order to get listed, the paid-up capital should be NPR 2.5 million (US$ 25,372), the company should have a minimum of 500 shareholders within two years of listing and it must have official audited company documentation and financials. Furthermore, to remain listed, companies have to renew their licence by paying annual renewal fees to a maximum of NPR 50,000 (US$ 507). In 2014, NEPSE had 59 companies that failed to pay the annual listing fee (NEPSE, 2014).

Distribution channels

This section outlines the current traditional and alternative distribution channels used in Nepal, in the process also identifying a number of future opportunities for extending distribution.

Traditional distribution

Poor banking infrastructure. Figure 61 shows the bank branches and ATM infrastructure in South Asian countries. Nepal has significantly low levels of bank distribution compared to the region. Nepal's overall bank infrastructure includes 1,547 commercial bank branches across the entire country, with an average of 8.47 branches per 100,000 people. In terms of the distribution of ATMs across the country, Nepal has approximately 8.88 ATMs per 100,000 people, which comes only ahead of Afghanistan (IMF, 2014).

BFIs concentrated in urban areas, but slowly expanding outwards. As shown in the heat map (see Figure 62), the number of bank branches is fairly limited in Nepal and is concentrated around the hill and Terai regions. Nepal has 3,465 bank branches across the country, of which 1,547 branches are of commercial banks and the rest belong are of class B, C and D banks (Nepal Rastra Bank, 2014).

The branches are concentrated around the smaller urban areas, with substantial gaps in coverage between the towns. The capital city, Kathmandu, has the highest density of bank infrastructure. NRB has been encouraging banks to open branches in rural areas by the introduction of a requirement that BFIs open two rural branches before opening a branch in Kathmandu Valley. Although the number of bank branches is increasing, the majority of the banking activities are still concentrated in urban areas. FSPs are concentrated in urban areas, market centres in rural areas, the Terai region and the more accessible sections of the hill and mountain regions.

Remote rural areas are difficult to access and have poor infrastructure, which increases operational costs for formal providers, making the market less viable. Regions that lack formal banking service providers are generally characterised by the proliferation of informal providers.

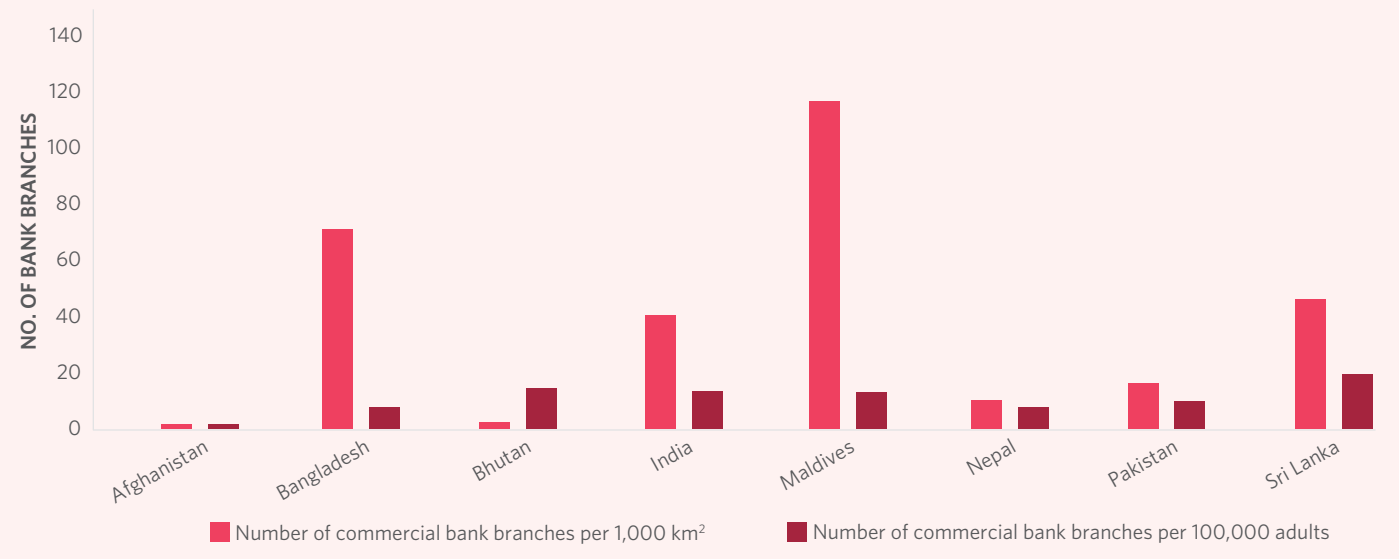


Figure 61: South Asia's bank branch infrastructure

Source: IMF, 2014.

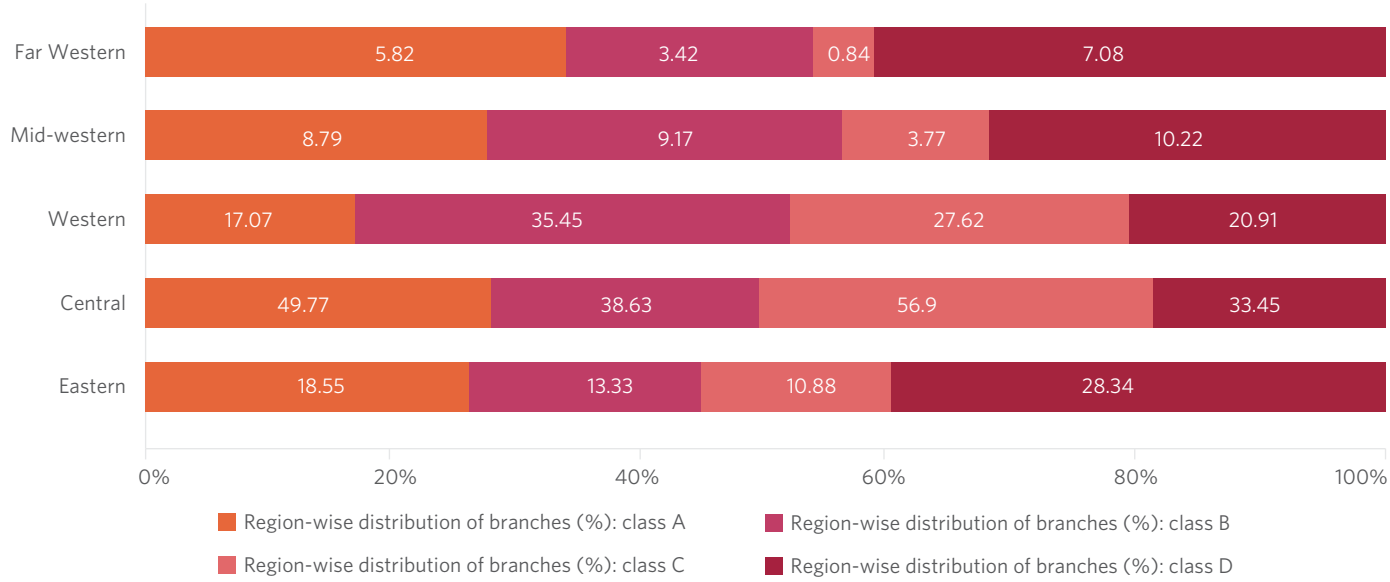


Figure 62: Distribution of bank branches in Nepal

Source: Authors' own based on Nepal Rastra Bank Annual Reports, Annual Bank Supervision Report, 2014.

Travel substantially contributes to the cost of accessing financial services. Table 30 shows that 29% of the adult population have access to a bank within 30 minutes. Given that banks are concentrated around the urban areas, rural dwellers need to travel long distances to access financial services provided by such institutions. Almost 65% of adults have banking access only after travelling for more than 30 minutes, making it inconvenient for them to use formal financial channels. Moneylender are easily reachable within 30 minutes by almost 53% of the adult population, meaning that this informal channel is still more accessible and prevalent.

However, locally based FSPs – i.e. MFIs and SACCOs – have to a great extent overcome the barrier of proximity and cut down the travel time required to access other formal channel of accessing financial services.

Banks extending outreach. In terms of branch networks, as of mid-April 2015, the total branches of BFIs numbered 2,692: 1,656 of these were commercial bank branches; 797 were development bank branches; and 206 were branches of finance companies.

If all BFI branches are considered, the population per branch of BFIs comes down to 9,840.

In terms of regional distribution of branches: 46.2% of branches are in the central development region, while only 8.7% and 4.6% of branches are situated in the mid-western and far western development regions, respectively.

Banks using variety of channels to improve distribution. BFIs in Nepal are using a number of channels to distribute their services. In addition to using ATMs, banks are using branchless banking,

Provider	Don't know	Within 30 minutes	Within 30 minutes to 2 hours	Within 2 to 5 hours	More than 5 hours	Most common method of travel
Post office	17%	33%	40%	7%	3%	Public transport
Bank	6%	29%	41%	14%	10%	Public transport
ATM	38%	20%	28%	8%	7%	Walk
Mobile money agent	96%	2%	1%	0%	1%	Walk
Agent bank	84%	6%	6%	2%	2%	Walk
Hundi	72%	14%	10%	2%	2%	Walk
Moneylender	33%	53%	12%	1%	1%	Walk

Table 30: Travel time, difficulty and mode for adults to reach financial service touchpoints

Source: FinScope, 2014.

point-of-sale (POS) banking, Internet banking and mobile banking to extend their financial services reach. The acceptance and usage of cards, mobile banking and Internet banking is slowly gaining momentum and popularity due to its convenience and flexibility.

Agent banking emerging as an effective distribution channel. As mentioned, the provision of banking activities by licensed banks and financial institutions themselves or through their appointed agents through the use of smart card or magnetic card from point of transaction machines is defined as branchless banking. A bank can appoint an agent to offer the authorised services, who will, under the agreement provide banking services to the customers. Agent banking has proven to be an economical channel of delivering financial services without relying on the high cost of setting up a traditional bank branch (Veniard, 2010). The banking agents use POS devices equipped with a bio-metric fingerprint scanner, which allows the agent to provide banking services, including deposits, withdrawal and payment. The easy proliferation of banking agents has facilitated the expansion of the banks' reach. In 2014, there were 2.63 active mobile banking agents per 100,000 customers. Branchless banking centres have increased in number to 504 (1 per 300 customers) and are directly serving 151,066 customers (Nepal Rastra Bank, 2014).

Lack of uninterrupted power source and basic infrastructure increases the cost of operating an ATM. When running an offsite ATM, the biggest costs are the annual ICT maintenance costs. Rental costs and security and liquidity costs are also significant. Moreover, in Nepal extended power cuts makes it necessary to arrange an alternative source of power, which significantly increases the cost (MAP qualitative study, 2015).

A study of transaction pricing across the banking industry revealed that, aside from an annual renewal fee for ATM cards, banks don't usually charge their own customers for using the ATM. Although the cards issued are accepted across banking channels, the charges vary depending on the switches; however, the fees earned from non-customer ATM usage are unlikely to cover running costs (Institutions, 2016). In order to justify the cost of putting up an ATM, it must be cross-subsidised with earnings from other bank activities.

Currently, there are 1,362 ATMs and 3,641,960 debit card holders (Nepal Rastra Bank, 2014).

Despite interoperability, the charges levied in ATM usage are resulting in concentration of multiple ATMs in a single area. Although bank clients are provided with free withdrawal service in the same bank network ATMs, the charges are levied for withdrawing from other ATMs (Dhungel, et al., n.d.). This means that although there might be sufficient ATMs in an area, banks will nevertheless have to establish their own ATM network. Generally, if there are more than 2,000 customers in a branch the bank provides an ATM service (Institution, 2016).

Microfinance development banks growing steadily. Due to the open licensing policy on MFIs, their numbers are growing steadily. NRB has not put any moratorium on licensing of those institutions opened with the aim of financial expansion and inclusion.

Table 31 provides information on the network of class D banks. The number of branches of microfinance development banks and Grameen Bikas Banks grew by 32% and 6%, respectively, to 851 and 170 branches, respectively, in 2013. These institutions rely on local community connections and are designed to serve the harder-to-reach mass market population, both through greater proximity and relying on connecting into communities to assist with credit profiling models. This requires widespread distribution networks, with branches in rural areas. In Nepal, most branches are located in Kathmandu.

SACCOs growing reach and spreading access but concentrated in market areas. The number of SACCOs under the Department of Cooperatives had reached 13,460 by mid-June 2015 (Department of Cooperatives, 2015). The financial cooperatives operate on a

	2012/13	2013/14	% change (i.e. increment in number of branches against increment in number of MFIs)
Number of MFIs	31	37	19%
Number of branches			
MFIs	646	851	32%
GBBs	161	170	6%

Table 31: Branch network of class D banks
Source: Nepal Rastra Bank, 2014.

membership basis in terms of which they serve the local people in the area in which they are based. This has helped to increase financial access in rural areas, where the SACCOs are rapidly expanding.

Figure 63 illustrates the regional distribution of financial cooperatives. These institutions have enormous presence in the central development region, and low presence in the far western and mid-western development regions (similar to the distribution of branches of BFIs). However, the Kathmandu Valley (which includes the three districts of Kathmandu, Lalitpur and Bhaktapur) alone has 4,137 savings and credit cooperatives and 586 multi-purpose cooperatives, which constitute 27% of the total financial cooperatives under the purview of the Department of Cooperatives in Nepal. Also, the proportion of deposits and investments held by these cooperatives constitute 58% and 48%, respectively, of the total holdings of financial cooperatives in Nepal (Department of Cooperatives, 2015).

Insurance sold through traditional channels. Consultations with insurers indicate that most insurance products are sold through agents or banks or directly from insurance companies.

Currently, there are 9 life insurance companies, 17 non-life insurance companies, 40 institutional agents, 87,155 life insurance personal agents and 1,162 non-life insurance personal agents (Beema Samiti, 2011). As of mid-July 2014, the total branches of insurance companies numbered 696, up from 643 a year earlier (Ministry of Finance, 2015).

Although the number of agents is high, the offering of services in rural area is still weak (INAFI, 2012). Two key factors that restrict expansion are limited institutional capacity and lack of infrastructural support.

Alternative distribution
As discussed above, the distribution of financial services to low-income and rural populations in Nepal is often challenging. Extending physical reach is difficult, due to the scattered settlement in difficult geographical locations and the limited supportive infrastructure.

Moreover, extending physical reach via branches with well-trained staff and traditional agents is an expensive exercise and often only possible to execute cost effectively in well-connected urban areas.

While the central bank regulation has required a broader outreach of bank branches to the rural areas, this is not yet on a sufficient scale to provide access for the majority of the population. For example, over 43% of adults (5,217,540) are an hour or further away from a bank branch (FinScope, 2014). Moreover, these traditional distribution points can sometimes be inappropriate for the low-income target market, in that 'doorstep barriers' in the form of unfamiliar and very formal distribution outlets add to these consumers feeling intimidated to take up services from this channel (i.e. too intimidated to even cross the doorstep).

By contrast, the *alternative forms of distribution* can reduce the cost of provision, while helping to improve the use of financial services, by providing a familiar and trusted environment for the users. Distribution of financial services is labelled 'alternative' when it occurs in partnership with institutions that are not the primary financial service provider or the channels commonly associated with that financial service provider. These channels could be other financial service providers (e.g. insurance distribution through banks), or institutions that see value in aligning their primary service offering with financial services (e.g. retailers, post offices and mobile network operators) (Cenfri, 2015).

This section explores some of the current and potential alternative distribution points in Nepal.

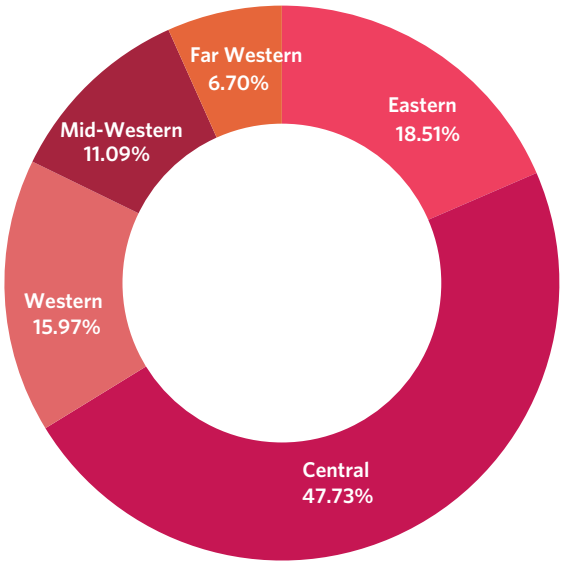


Figure 63: Regional distribution of financial cooperatives
Source: Department of Cooperatives, 2015.

Mobile technology
Leveraging mobile technology to expand access to finance is currently only being practised by the commercial banks and a few development banks through their mobile banking services. The mobile banking service is limited to urban centres and is mainly used for information dissemination. Only a few make use of it for vendor payments and fund transfers within the same bank. The mobile banking service providers in Nepal use SMS (short message service) to complete the transactions. Authentication of the transactions is done through encrypted SMS or personal identification number (PIN).

Value chain financing
Value chain financing is not new in Nepal and been practised *informally* based on social relationships. Important financial products such as agricultural financing and value chain financing are mostly absent from the service and product offerings of formal banking channels.

Given the fact that the majority of the population in Nepal are engaged in agriculture, there is tremendous potential for value chain financing. The BFIs are not attracted to value chain financing because of the rural nature of farmers (i.e. difficult to access), as well as the scale thereof (i.e. low-value loans) and the subsistence nature of the farmers (i.e. low and irregular levels of income) (Mercy Corps, 2010). Rather, BFIs prefer to provide wholesale loan to MFIs to cater to this segment.

Retailers
Currently, banks are joining hands with local grocery stores to act as their agents and providing limited banking services. The activities are mainly limited to account opening, cash-in/cash-out and remittances. Furthermore, the transaction volume of these services is very low – in terms of both value and number of transactions (MicroSave, 2014).

For the expansion of financial services, the agent network needs to be provided with adequate training and infrastructural support. Because of the current low volumes, liquidity has not been an issue, but in the long run, if this network is to be expanded properly, liquidity management planning and budgeting need to be done.

Post office
The Department of Postal Services of the Government of Nepal currently offers postal savings and money transfer services through its branches. The Department of Postal Services has a network of a single head office, 5 regional offices, 70 district offices, 842 area post offices and 3,074 extra departmental post offices spread across the country (Postal Services Department, 2015).

The Postal Saving Bank was set up to mobilise cash deposits with the objective of encouraging savings and using them for development the socioeconomic infrastructure of the country. Although 117 post offices are authorised to collect deposits, only 68 post offices have been providing banking services (as of mid-March 2015). The total deposit of postal saving banks, which was NPR 1.59 billion in mid-July 2014, had reached NPR 1.65 billion by mid-March 2015, with the number of accounts in such banks totalling 61,415 (Ministry of Finance, 2014/15).

Despite the wide network and government support, the role of the Postal Saving Bank has been negligible in the financial sector, mainly due to lack of technical skills (Nepal Rastra Bank, 2014).

Opportunities to expand distribution
This section sets out the alternative distribution channels that can be used in Nepal and, in so doing, identifies further opportunities for extending distribution of financial services and increasing access. Nepal is low overall in terms of its bank infrastructure outreach. While alternative channels do hold potential, often traditional channels are still required, both to support these channels and for consumers that prefer the traditional touchpoint.

The alternative distribution landscape in Nepal is still in its infancy or mostly informal. Potential exists to develop it further in the following areas.

Increase in traditional outlets, where appropriate. Given geographical constraints, expansion of traditional branches has been deemed a costly investment. However, with the incentive provided by the central bank to open branches in rural areas, traditional branches still play a key role in expanding distribution. With the end of the era of political conflict, the three government-owned banks (i.e. Rastriya Banijya Bank, Nepal Bank Ltd and Agricultural Development Bank Ltd) reopened 127 of the 284 branches that were closed during the conflict era of 1996–2006 (*The Kathmandu Post*, 2015).

Reach beyond urban areas low. Although the number of bank branches is increasing, these branches are generally located in urban and peri-urban areas. The penetration of bank branches in rural areas is low, with 82.8% of bank branches concentrated in urban areas (*The Kathmandu Post*, 2012). There is a need to adopt alternative distribution mechanisms to expand banking services in the rural, underserved market.

Given that 81% of the population is based in the rural areas, there is immense opportunity to tap this underserved market.

Branchless banking show potential for distribution growth area. Given the geographical diversity of Nepal, branchless banking technology has proven to be a cost-effective option for spreading reach. Serving a customer through a bricks-and-mortar branch includes the cost of renting the premises, as well as security costs, maintenance costs, staff salaries, among others. By contrast, the cost of a branchless bank agent is limited to the infrastructure and management to provide a POS device and service support to an agent.

Potential to leverage mobile phones and partnership with alternative channels. Using mobile phones to access financial services is convenient and reduces the transport costs needed to access traditional financial services. Saving and sending funds through mobile phone-linked accounts is also safer than using

most informal methods, as it removes easy access to physical funds. Mobile accounts further offer privacy from others, allowing funds to be built up anonymously without the pressure to lend to relatives or friends in need (often with little hope of being repaid).

Agricultural value chains represent an important potential distribution channel. Nepal has a large number of adults engaged in farming activities, and many would benefit from improved access to credit, savings and insurance products through formal value chain financing. Agriculture production in Nepal is largely made up of smallholder farmers that focus on subsistence farming. It is a dominant sector in Nepal that touches a high proportion of the population, and therefore holds potential to be leveraged to distribute financial services on a broad scale. Agricultural value chains offer rural footprints not achieved by most other distribution channels. Agro-dealers are also generally networked and have incentives to see farmers prosper to obtain harvests to process and on-sell. Offering farmers input credit to enable them to plant, fertilise and grow their crops increases the likely yield to the agro-dealer.

Furthermore, mitigating risks through insurance that maintains the productivity of the farmer and the crop would be valuable to ensure that this yield occurs. The government provides a subsidy of 75% on the premium of crop insurance, which cushions a farmer in bad seasons and provides the necessary capital to continue farming in the following season after a crop failure. This again benefits the agro-dealer, who is dependent on future harvests.

Financial service distribution through agro-value chains requires a number of farmers linked to a large aggregator – the latter ideally also being the institution that purchases the produce from the farmers.

Financial services distribution by retailers could benefit individuals and retailers alike. The FinScope survey reports that 82% of Nepali adults are within walking distance of a grocery store, as compared to just 15% who are within walking distance of a bank. This indicates that accessing a grocery store would be easier and – most importantly – less expensive than accessing a bank, as no transport costs would be incurred. Retailers in Nepal, therefore, represent a broad touchpoint for reaching all Nepalis.

Furthermore, many people in rural areas feel intimidated or uncomfortable at the prospect of transacting in a bank and interacting with bank staff, and are more willing to access financial services from a trusted retailer who is well known to them.

Distributing financial services through retailers can also be highly beneficial to the retailers, as increased numbers of customers frequent the store, which opens up the opportunity for increased profits through cross-selling.

Postal services a potentially viable alternative distribution channel of financial services, leveraging on existing wide network and coverage. The post office could extend financial services by going beyond offering payments to a full-service offering – including credit, insurance and savings in collaboration with the BFIs and insurance companies. This would require investing in upgrading of systems infrastructure in order to improve the information systems capability, and upgrading of technical know-how and financial literacy of staff to enable them to play a larger role in providing financial services.

Notes

2 Monetary Policy for 2015/16, issued by NRB includes directives to increase the paid-up capital of banking and financial institutions by mid-July 2017.
3 Rastriya Banijya Bank Limited is the largest bank of Nepal in terms of deposit mobilisation and is fully owned by the Government of Nepal (RBBL, 2016). The Government of Nepal has 38.60% ownership in the equity capital of Nepal Bank Limited, and 51% shares of Agriculture Development Bank Limited, which was initially established as a development bank to promote the agricultural sector with 100% government ownership and was upgraded to a commercial bank in 2006 (ADBL, 2013).
4 During this period, Kist Bank had an NPL of NPR 0.53 billion while Grand Bank had an NPR of NPR 2.38 billion at the end of FY 2013/14. In FY 2015/16, Prabhu Bank successfully acquired both Kist and Grand Bank.
5 Bagmati zone has the highest concentration of development banks branches (166 branches), which is mainly attributed to the high urban population; whereas Karnali zone does not have a single development bank branch. District wise, Kathmandu records the highest number of branches with 92 development bank branches, followed by Rupandehi (74 branches), Kaski (69 branches) and Chitwan (69 branches). However, districts such as Darchula, Bajura, Bhajang, Dolpa, Kalikot, Humla, Jumla, Salyan, Rolpa and Rasuwa do not have any development bank branches (Nepal Rastra Bank, 2014).
6 With many different types of financial institutions competing for the same market segment, there is stiff competition for finance companies, institutions that usually has a higher cost of funding. Most of the good loans have started to shift to banks, due to low interest rates, and this has put increased pressure on finance companies. As a result, finance companies are being squeezed between the options of lowering the cost of funds and consolidating/merging with other financial institution with a strong capital base. This has created an environment for merger and acquisition (Beed, 2016).
7 The figures for Rastriya Beema Sansthan (RBS) have been projected by the IB, since only the financials until FY 2002/03 have been audited and approved by the Annual General Meeting (AGM).
8 There were 29 commercial banks, 97 development banks, 48 finance companies, 22 insurance companies, 18 production and manufacturing companies, 4 hotel companies, 4 trading companies, 8 hydropower companies and 2 other companies listed on the NEPSE as of mid-March 2016.
9 It is mandatory for selected company documents, such as audited financial reports and annual reports, to be submitted to NEPSE at the end of each year in order for the company's listing to be renewed. In 2014, only 62 listed companies submitted the annual reports on time while 90 companies made late submissions (SEBON, 2013/14).
10 There are currently nine hydropower companies listed in the secondary market and they have issued shares to the local people. There are multiple hydropower companies in the pipeline issuing such shares to the local people.

Target market segments

Overview of the Nepal target market segments

The FinScope survey (2014) yielded six distinct target market segments for Nepal, as illustrated in Figure 64.

Farmers (4,667,010 individuals – the largest target market at 32% of total adult population) – those who obtain their income from farming activities. Of these, 75% are subsistence farmers.

- Majority are based in rural areas.
- Majority have only primary or lower educational attainment.
- The gender split is more or less equal.
- 65% of this target market use primarily informal financial services.

Irregular earners (2,395,851 individuals – the third largest target market at approximately 17% of total adult population) – those engaged in piecework (i.e. paid according to their work output) as main source of income.

- Majority are based in rural areas.
- This group is the least literate.
- Majority are males.
- Has the lowest access (of all the target markets) to formal financial services.
- 33% of this target market primarily use informal financial services.

Dependants (2,475,569 individuals – the second largest target market at approximately 17% of total adult population) – those whose main source of income is family and/or friends, often a household member. Also includes recipients of government grants and welfare benefits.

- Majority are based in rural areas.
- Majority (53%) have attained only primary or lower education levels.
- Majority are females.
- The poorest target market.
- 29% of this target market use formal financial services, while 33% remain excluded.

MSMEs (1,912,428 individuals – the fourth largest target market at 13% of total adult population) – those whose main source of income is from owning and running a micro, small or medium enterprise.

- Majority (68%) are based in rural areas. (But given that 81% of the adult population are rurally based, MSMEs are actually proportionally more urban.)
- The second most educated group.
- Majority are males.
- The second highest income earners.
- 51% of this target market use formal financial services.

Remittance receivers (1,601,042 individuals – the second smallest target group at 11% of total adult population) – those who rely on remittances sent by relatives or friends (internationally or domestically).

- Low education levels.
- Majority are females.
- Worth noting: the third highest income earners.
- 52% of this target market use formal financial services.

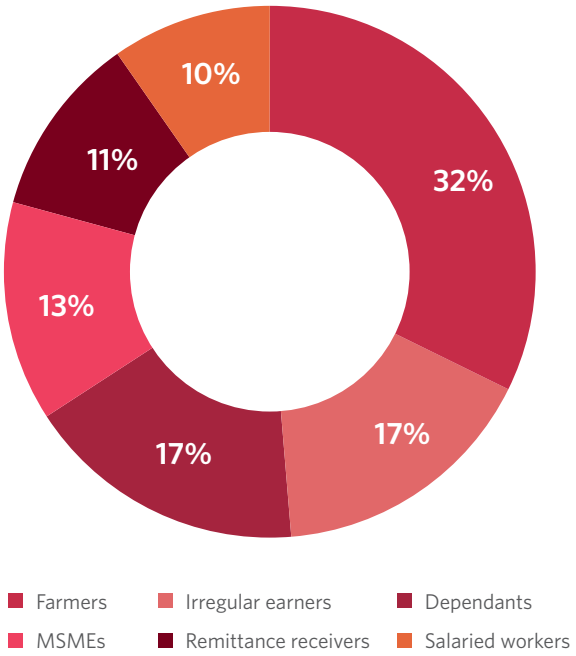


Figure 64: Size of target markets as a percentage of total population
Source: FinScope, 2014.

In a highly patriarchal society, the fact that the majority of remittance receivers are female means a significant shift of wealth into the hands of female members of the population. Most migrants are males, which increases the likelihood that the female left behind has to become a decision maker in day-to-day financial services usage, even if major decisions are still made in combination with the male spouse or family member who has migrated.

Salaried workers (1,415,766 individuals – the smallest target group at 10% of total adult population) – those whose main source of income is salaries drawn from employment in private companies and in government or public enterprises.

- Most urbanised of the target markets.
- Highest levels of education of the target markets.
- Majority are males (the target market with the most males).
- The highest earners.
- Majority of target market (66%) use formal financial services.
- Only 15% of this target market use all four types of financial services; most (40%) use only one or two.

Unpacking the six target market segments
Salaried workers

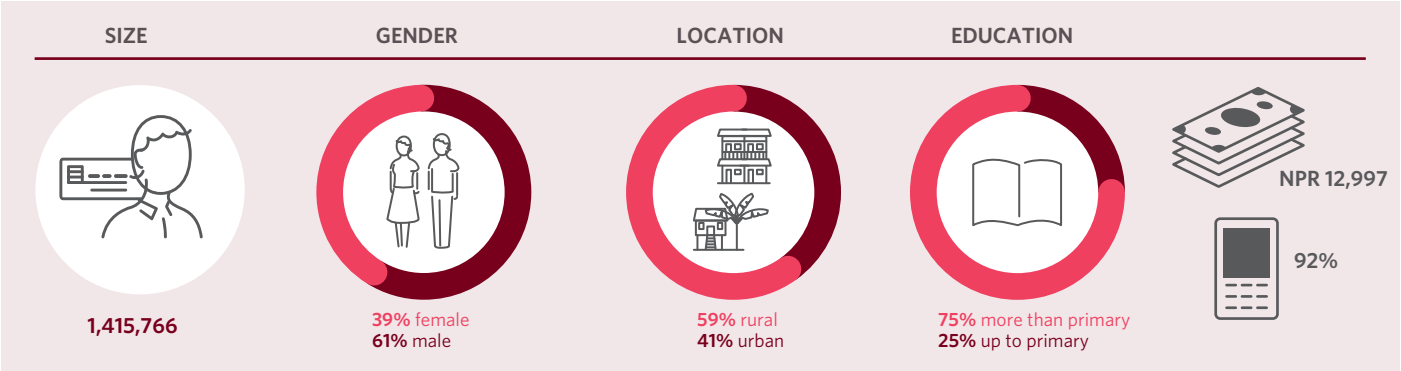


Figure 65: Salaried workers – key indicators
Source: FinScope, 2014.

Highest income, best-educated, youngest, and most urbanised segment. Salaried workers consist of both government and formal private sector employees. As shown in Figure 65, this target market has a significantly higher average income compared to other target market segments (more than 1.24 times than that of the second wealthiest target market segment).

Perhaps surprisingly, among the salaried workers, 12% earn less than NPR 5,000 (US$ 51) per month – which is lower than the average national income of NPR 6,669 (US$ 68).

As a group, salaried workers have the highest education levels of the target market segments, and higher-than-average education levels. Particularly worth noting is the high level of tertiary education, which stands at 24% of the target market segment.

Salaried workers is the target market segment with the highest male dominance (61% of salaried workers are male versus the population average of 47%).

It is also the youngest group, with an average age of 34 years (as compared to the population average of 38 years).

This target market also has the highest urban dominance (41% of salaried workers are in urban areas versus the population average of 19%), as well as an unusual dominance in the hill areas (51% of salaried workers are in the hill areas versus the population average of 44%). Despite a high urban dominance, this group is still for the most part rurally based; one driver of the high number of rurally based salaried workers is employment in government institutions, which are well represented across rural and urban areas alike.

Best-served target market segment. As shown in Figure 66, salaried workers are the target market segment with the highest levels of access to financial services. They are particularly well served by formal financial services:

- 83% of salaried workers access formal channels (versus the population average of 60%).
- 8% of this group taking up informal services only.

"My salary is deposited directly into my salary account on the third day of the English calendar. I have a debit card as well as a credit card. The credit limit on my credit card is equivalent to my salary. I have taken a motor loan as well for which I had to submit my salary statement. I also maintain a different saving account in the same bank wherein I transfer the remaining portion of my salary through online fund transfer." (Salaried worker – IT, aged 32)

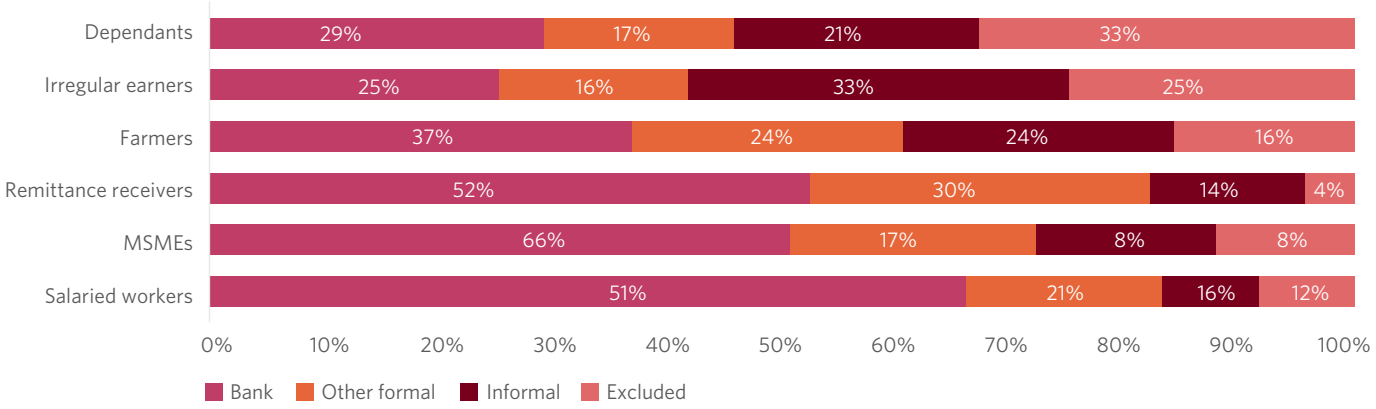


Figure 66: Usage of financial services per target market
Source: FinScope, 2014.

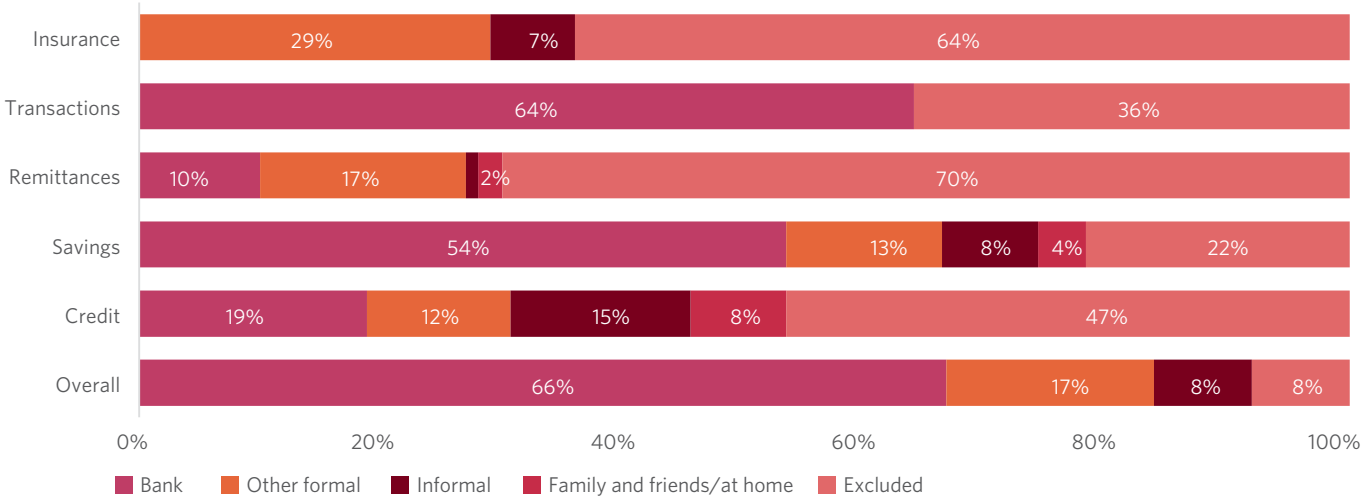


Figure 67: Salaried workers: access strand across product markets
Source: FinScope, 2014.

High and regular income drives formal uptake of salaried workers. One differentiating factor that drives the high level of formal access is that salaried workers have a relatively high and regular income as well as documents for proof of income, which gives this target market easy access to formal channels.

However, the financial service uptake of informal channels is also significant.

Savings and transactional products most accessed. As evident in Figure 66, only 8% of salaried workers are excluded from all financial services. Saving products are key for this market (78% of salaried workers save), followed by transactions (64% of the segment). This is high compared to the other groups and is likely caused by salaried workers depositing their salary and withdrawing cash on a regular basis from banks to meet daily household needs.

Dominant group for formal credit uptake. The high access to formal services (already discussed) is further illustrated by this segment's position as the dominant group in terms of formal credit uptake.

Highest access of all the segments to insurance. Lastly, 64% of salaried workers are excluded from access to insurance, although compared to the other target market segments this group has the highest access to insurance. High income levels are a key driver for this, along with the incentive push of a tax rebate on purchase of life insurance products, as well as mandated products by the government (e.g. vehicle insurance) or their employer (e.g. medical insurance).

"Medical insurance is a component of my salary package. Besides, as a form of forced saving and to avail tax rebates, I have life insurance. Currently I have third party insurance for my motorbike, which is required by law." (Salaried worker, female, aged 32)

Deepest served, with depth of usage the best of all the segments. Figure 68 shows the depth of financial service usage by salaried workers: 79% of all salaried workers use more than one financial product (this is the highest out of the target market segments), and, of those, the largest contingent (38% of the salaried workers) use a combination of three financial services. The most popular combination consists of savings, credit and payments, with 19% of salaried workers using this combination.

Main financial service needs

The depth of coverage for this market indicates that there is potential across the product categories to increase access. Savings and payments are well provided for in terms of initial access, but this is an area that can be examined further to test whether customer needs are being holistically well served or

Figure 68: Depth of financial service usage
Source: FinScope, 2014.

whether there is potential for increasing the value of services on offer. The overlap of usage between providers points to this, indicating that no single provider is currently providing a product that holistically serves customer needs.

In this target market segment, credit and insurance uptake are high in relation to population averages, but still show substantial excluded populations, along with evidence of usage across a range of providers. There is the potential to increase access and the level of usage of all products.

The high level of formal access to transactional accounts for this group (which receives a stable income) indicates that there is potential for formal service providers to tap into this market by cross-selling/bundling savings, credit, insurance and payment products to increase access further.

The high levels of male dominance in this target market segments suggest the likelihood of there being a large number of breadwinners in this segment. This suggests that financial services need to support a household's needs, such as savings (for immediate and long-term needs), insurance to cover household risks (e.g. medical insurance) and/or credit (e.g. to support asset accumulation or investment in education).

However, the likelihood that the country's inflation levels will rise with no significant increase in real income will affect the need for various financial services; with lower real income and higher inflation levels, people's need to provide for consumption smoothing is likely to increase.

MSMEs

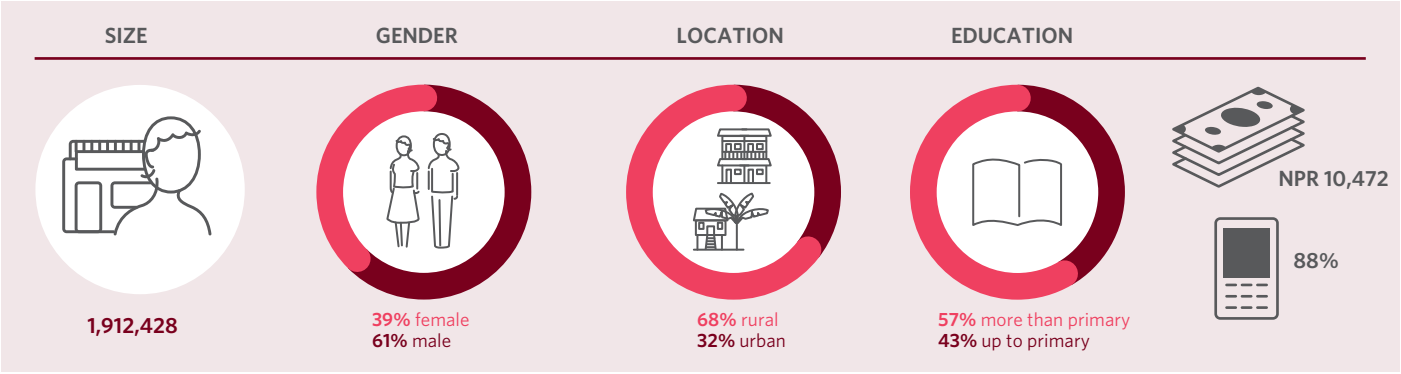


Figure 69: MSMEs – key indicators

Source: FinScope, 2014.

MSMEs play a key role in economic development. MSMEs in Nepal have been key contributors to economic development, as they play a significant role in creating self-employment opportunities, mobilising and using local resources and, consequently, raising the income level of the population. For example, it is estimated that MSMEs form more than 96% of the total industrial establishment, contribute 83% to industrial employment generation and share 80% of the industrial sector's contribution to the national GDP (Dahal & Sharma, n.d.).

This group also forms 13% of the adult population (1,912,428 adults) and is therefore a substantial target market segment with the opportunity for real economic impact.

However, it should be noted that this group includes a range of types and sizes of businesses and therefore the potential impact will vary across each group.

Formal MSMEs numbers understated due to high informal market prevalence. Approximately 183,006 MSMEs are registered with the Department of Cottage and Small Industries (DoCSI, n.d.). The figure is likely understated due to the high level of informal market function in Nepal (e.g. the informal economy contributed 38% of GDP in 2010). The key driver of formal registration with the Department of Small and Cottage industries is tax benefits. Nevertheless, this has not been a sufficient incentive for the majority of MSMEs to go through the complicated and expensive registration process with the department, although many have registered with Small and Cottage Committees in rural areas or the Department of Commerce and Supplies and Municipalities in urban areas (in compliance with the Private Firm Registration Act, 1958).

Young, male and rural target market. Even though MSMEs are rurally dominant, this target market has a high urban presence (32% of MSMEs are in urban areas versus the population average of 19%). The group also has a high male dominance (54% of MSMEs are male versus the population average of 47%) and a young average age of 37 years versus the population average of 38 years.

Well-educated target market focused on trading activities. A considerable number of MSMEs (53% of the group) have a formal secondary education, making this target market the second most

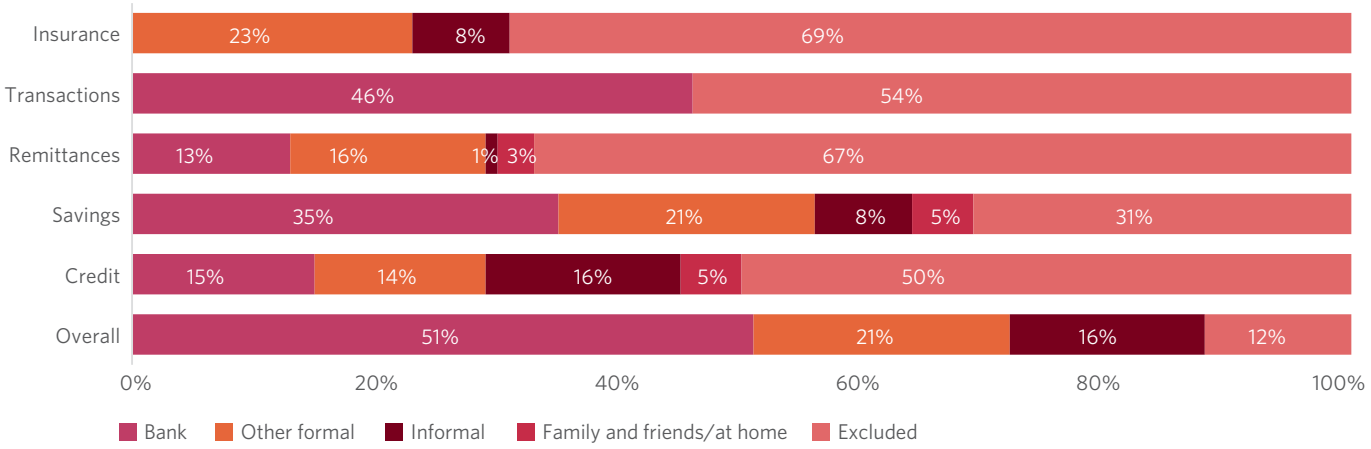


Figure 70: MSMEs: access strand across product markets

Source: FinScope, 2014.

educated group. This is noteworthy because of the potential skill level that this could indicate.

In urban areas, MSMEs are typically engaged in retail business, wholesale business or selling groceries, while in the rural areas MSMEs are typically engaged in selling agricultural produce or livestock, selling groceries or selling traditional herbs and medicine (MAP qualitative survey, 2015).

MSMEs are mostly family-run businesses. MSMEs are family-level enterprises set up with family savings and sometimes supported by friends and family (European Economic Chamber, n.d.). These businesses are passed on from one generation to another (usually to the children of the owners). The ownership and management is controlled by the same individual – usually the head of the family –with powers over all decision-making and issues of the enterprise. Due to the family link, personal and family savings are generally the major source of capital (European Economic Chamber Nepal, n.d.).

"My father inherited this business from his father. Currently, my younger brother and I run the business. In fact, even our wives look after the shop. The final decision relating to any business matter is taken by our father." (MSME, shop owner, male, aged 35)

Higher-than-average incomes, with household expenses accounted for in business expenses. The average income levels of MSME owners is the second highest within the target markets, with an average monthly income of NPR 10,472 (US$ 106). As indicated by FinScope (2014), 28% of MSMEs (versus the population average of 48%) supplement their income through farming activities.

The qualitative research also indicates that the financial decision-making of MSMEs happens at the household or individual level. In fact, there is no clear separation between household and business finances, and as a result the MSME's needs are combined with the household expenses. However, this tendency is prevalent mainly in micro and small enterprises that are family run.

"My shop is the main source of our family income. We use the income for all our household expenses, for buying everything the family needs – from education to food supplies. We even consume biscuits and other supplies from our own shop. The shop is ours, so we do not differentiate between family expenses and shop expenses." (MSME, shop owner, aged 53)

High usage of formal financial services by MSMEs, with significant use of informal channels. Informal financial services channels are common in both urban and rural areas and are based on personal relationships and proximity. The informal channels provide a wide range of financial services, which are beyond the purview of financial sector regulations. Rather than offering a bundle of financial services, the informal channels tend to focus on one service: savings, credit, remittance or insurance.

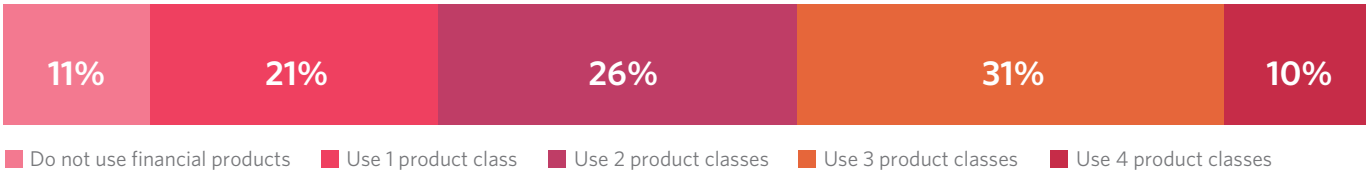


Figure 71: Depth of financial service usage

Source: FinScope, 2014.

Figure 70 indicates that 72% of the MSME target market segment have access to formal financial services, while 12% are excluded from all forms of financial services. However, the uptake of financial services from informal providers is significant, when overlaps are taken into account, with informal credit use topping its formal counterparts (21% of MSMEs) and informal saving on a par with formal providers (13% of MSMEs versus 35% and 21% for banks and other formal, respectively).

Most significantly, 46% of MSMEs have access to formal payment services, implying that these businesses can transact in both cash and through formal payment systems, mainly bank cheques (MAP qualitative survey, 2015). The preference for cash transactions can be traced to the fact that use of cash is the preference and the norm in Nepali society, and is further reinforced by merchant discounts for cash, the lack of additional finance charges attached to the use of cash, and an extensive informal sector that tends to be wary of transacting digitally.

"I have opened a savings account for my business in a development bank. I usually pay my creditors using cheque, but there are many creditors who demand cash and they provide cash discount. I approached the bank for the SME loan to expand my processing facility. But I learnt that I had to provide my business income details. I provided the bank with the documents they requested but the loan provided was insufficient so I had to borrow from friends and family. Later, after the earthquake, the construction materials more than doubled, so I had to take a loan from a local moneylender to complete my construction." (MSME, entrepreneur – chamomile processing, male, aged 42)

Insufficient credit available for expansion. Access to formal institutional credit for MSMEs, despite provision for this, is limited due to requirements for capital to be put forward as equity, poor maintenance of business records and insufficient collateral security (MAP qualitative survey, 2015). Given that credit information in the market is limited, banks and financial institutions have attempted to cover their risks by relying on conventional collateral-based lending approaches, which often, however, set collateral requirements at a level that is difficult for the typical MSME to match. More MSMEs have been able to access credit through informal providers (22% of MSMEs when overlaps are taken into account), but this still places overall current access to credit at 50% of MSMEs. The MAP qualitative survey indicates that the majority of the capital financial requirement is met by ploughing back savings earned from the business. However, the amounts provided by savings after allocating income to other needs is not enough to fill the credit gap (MAP qualitative survey, 2015).

Depth of usage more moderate than other target markets. Of all MSMEs, 67% use more than one financial product. The highest number of MSMEs use a combination of three financial services (31%), while the use of a combination of two financial services is the next highest (26%) (see Figure 71). The most common product combination is credit, savings and payments, with 16% using this combination.

Main financial service needs

Managing their finances is arguably the most important component of the MSME segment's financial service needs. MSMEs require timely and adequate capital infusion through working capital and investment capital, in order to allow for expansion and making the most of business opportunities. In particular, the nature of the business of trading (i.e. the majority of the MSMEs) requires upfront capital to invest in stock for trading. However, MSMEs' capital is limited by the fact that most meet this need through own savings or borrowing (at an inadequate level). There appears to be an undersupply of funds to service the working capital and investment capital needs of MSMEs. It is important to focus on overcoming some of the barriers in the credit system, in order to ensure that MSMEs that are able to absorb and repay credit have access to it.

There is also, however, a need for innovative product design to assist MSMEs to provide for – and protect – their capital needs through other sources (e.g. savings and insurance).

A larger number of MSMEs need to transact to support their business and personal needs, and they require payments to facilitate this need. Payments can include both digital transaction products and infrastructure that provides access to cash (given the high preference for cash already noted).

Blurred lines between household and business needs cause MSMEs to divert money meant for business growth to dealing with personal issues, such as the death of a family member, a wedding, education fees and purchasing household supplies, and vice versa. The multitude of demands on these funds can result in a deficit of capital to fulfil all of these needs. Hence there is a need for committed saving products that help in consumption smoothing as well as helping MSMEs to save to meet the business requirement of working capital and investment capital.

Remittance receivers

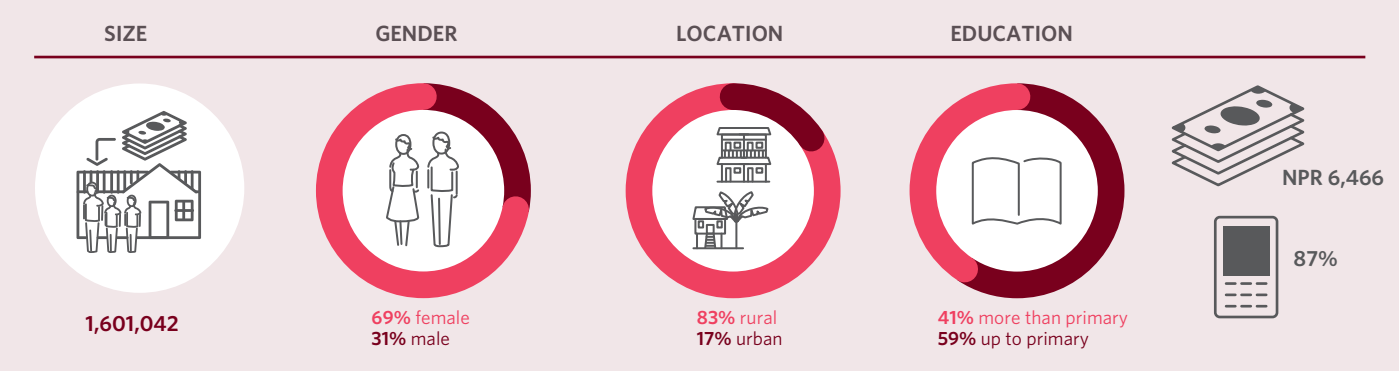


Figure 72: Remittance receivers – key indicators
Source: FinScope, 2014.

Remittance receivers are predominantly female, with low levels of education and rurally based. Remittance receivers are the second smallest target market segment, but still form a substantial group with a population of 1,601,042 (11% of the total adult population). The group is dominated by females, with 69% of remittance receivers being female (compared to the population average of 53%).

This target market segment follows the population norms for spatial distribution: the rural and urban spatial distribution is 83% and 17%, respectively (compared to the population average of 81% and 19%, respectively).

Remittance receivers are characterised by low education levels, with only 39% of the segment attaining secondary school education and 2% attaining tertiary education.

"There are limited employment opportunities in the village. Income from agriculture is barely sufficient to cover daily expenses. It is mostly the men who go to Saudi, Doha, Malaysia and Korea in search of foreign employment, leaving behind their wives and children. It has become a tradition that at least one male member of the family go abroad for foreign employment." (Remittance receiver, shepherd, female, aged 36)

Relatively higher income than other target market segments. Remittance receivers have the third highest average income, with average monthly income of NPR 6,466 (US$ 65). The income levels of this target market group are similar to those of dependants, in that they are likely to receive income closely related to their needs due to the fact that their income is not attached to a business activity but to another's assessment of their needs. The fact that remittance receivers receive a relatively higher income speaks to the earning potential of the migrants abroad.

Increase in foreign employment shows growth potential for the target market. There is increasing growth in the number of migrants for foreign employment, with the Ministry of Labour and Employment reporting an increase of 137% between 2008/09 and 2013/14. The increasing trend of migration suggests that the number of remittance receivers could also continue to increase.

Remittances and savings key products. As shown in Figure 73, remittance is naturally a key product for this target market. Formal remittance is the favoured product channel, along with family and friends (22% of remittance receivers when overlaps are included).

The 12% of remittance receivers that are excluded from recipients are adults that receive their primary income from remittance, but are not the adult that directly accesses the service to do so. This is likely done by a member of their household, following which the necessary funds are handed across to the remittance receiver.

As with the other target markets, savings are a key product. One driver of this is that remittance is usually paid on a quarterly basis, meaning that receivers will need to save a portion of the funds for consumption smoothing over the three-month period (FinScope 2014; stakeholder interviews, 2015).

Both formal and informal providers are accessed by remittance receivers to provide for this need:

- 28% of the segment access saving through informal providers (this figure includes overlaps)
- 25% access saving through banks
- 12% access saving through other formal providers.

"I receive money from my husband every three months. My husband, along with his two other friends, pool in their income and send it to a family on a rotational basis. This is useful because we have more money in hands. The money I receive comes via Prabhu remittance. The remittance money is received directly in my savings account. I generally withdraw money as and when required." (Remittance receiver, basket weaver, female, aged 42)

Aside from savings and payments, remittance receivers are also the second highest users of digital transactions after salaried

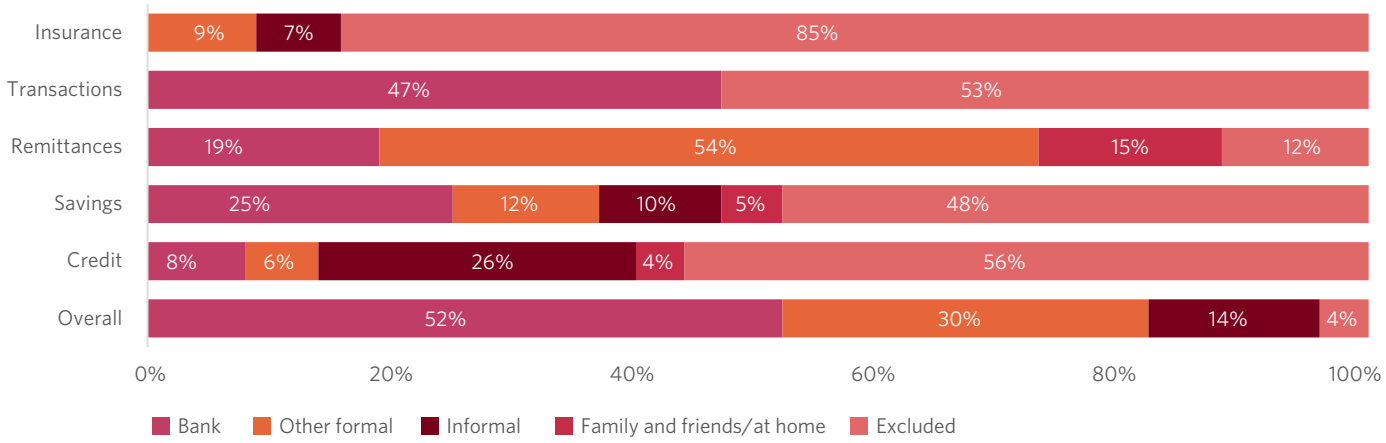


Figure 73: Remittance receivers: access strand across product markets
Source: FinScope, 2014.

workers: 44% of the target market had accessed credit in the previous 12 months. This is mainly from informal providers, which is understandable given eligibility criteria (e.g. proof of income) that formal providers are likely to request.

Depth of financial service usage. As illustrated in Figure 74, 68% of all remittance receivers use more than one financial product. The largest contingent (37%) use a combination of two financial services, with 23% using a combination of three financial services. The most popular combination consists of savings and payments, with 19% using this combination.

Main financial service needs
Remittance users have the highest level of access to financial services out of the target markets. This is strongly driven by the fact that this target market needs to access financial services to receive the income that is sent via remittance channels.

Since remittance received is usually on a quarterly basis, there is a need to smooth out this income through savings and potentially credit to cover for the shortfall in income when they do not receive remittances.

This target market segment has the third highest income levels and currently depends on a third party for their income; both of these factors indicate a likely need to save to invest surplus for the purpose of creating a financial safety net. Other products that could assist in this manner are those that assist with risk mitigation and asset accumulation (e.g. home loans).

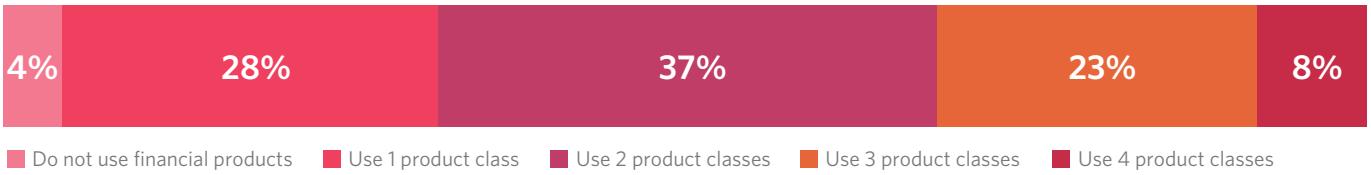


Figure 74: Depth of financial service usage
Source: FinScope, 2014.

Irregular earners

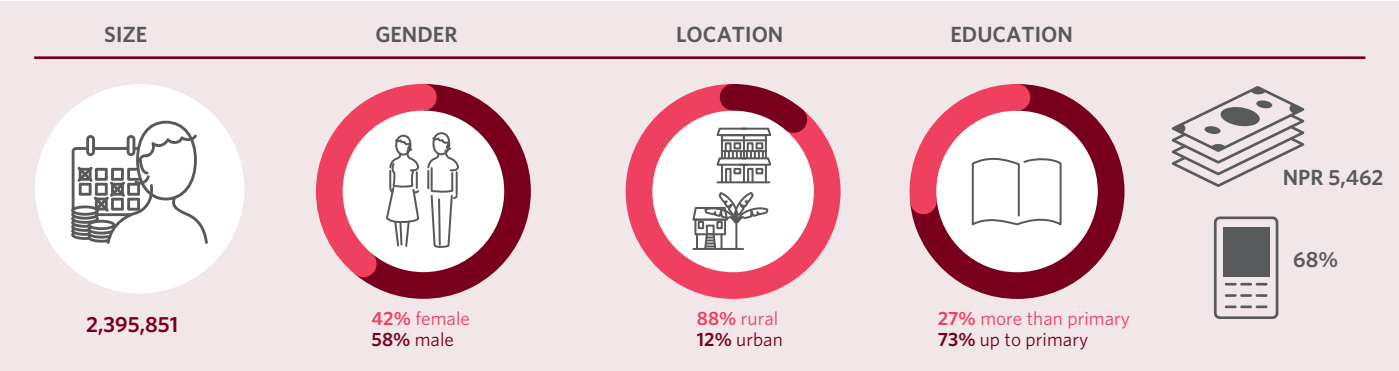


Figure 75: Irregular earners – key indicators
Source: FinScope, 2014.

Large target market segment of mostly males, with low, irregular incomes and lowest literacy. Irregular earners are the third largest target market segment in terms of size, and on average earn a monthly income of NPR 5,462 (US$ 55), an amount that is lower than the population average and almost equal to the average income of farmers.

The nature of the piecework taken up by irregular earners means that their income stream is unpredictable.

This is the target market with the second highest male dominance (58% of irregular earners are male versus the population average of 47%).

Irregular earners have the highest dominance in the Terai region (62% of irregular earners located in this region versus the population average of 50%).

This target market accounts for the lowest literacy levels, a fact well correlated with low-skilled work.

Irregular earners have a significantly high dominance in rural areas (88% of irregular earners are in rural areas versus the population average of 81%) and, as such, are well placed to fill the workforce gap in rural areas that results from migration of others to urban areas and other countries (Magar, 2008).

"I own a small piece of agricultural land and the crops I grow are only for self-consumption which is insufficient to last me a year. So I do odd jobs around the village like during the sowing and harvest season I work on bigger farms on a daily wage. Besides, I also work as a daily construction labourer on a daily basis but the work is not regular. Whenever I am in need of money I try and borrow from friends and family; otherwise there is a moneylender who provides credit at 4% per month." (Irregular earner, daily labourer, male, aged 38)

Financial service usage is mainly informal. Compared to the other target market segments, irregular earners have the second lowest access to financial services (see Figure 76). In terms of uptake of financial services, informal providers and friends and family are key financial providers for this segment, although formal providers and family and friends are almost on a par.

Figure 76 provides an overview of financial access for irregular earners. Savings and credit are key products for this target market segment, which has with irregular income flows and is highly vulnerable to shocks that affect daily labour, because such products provide access to surplus funds. In both cases, the use of informal providers dominates. When overlaps are taken into account, 36% and 27% of irregular earners access credit and savings this way, respectively. In combination, formal providers also provide 27% of irregular earners with savings products.

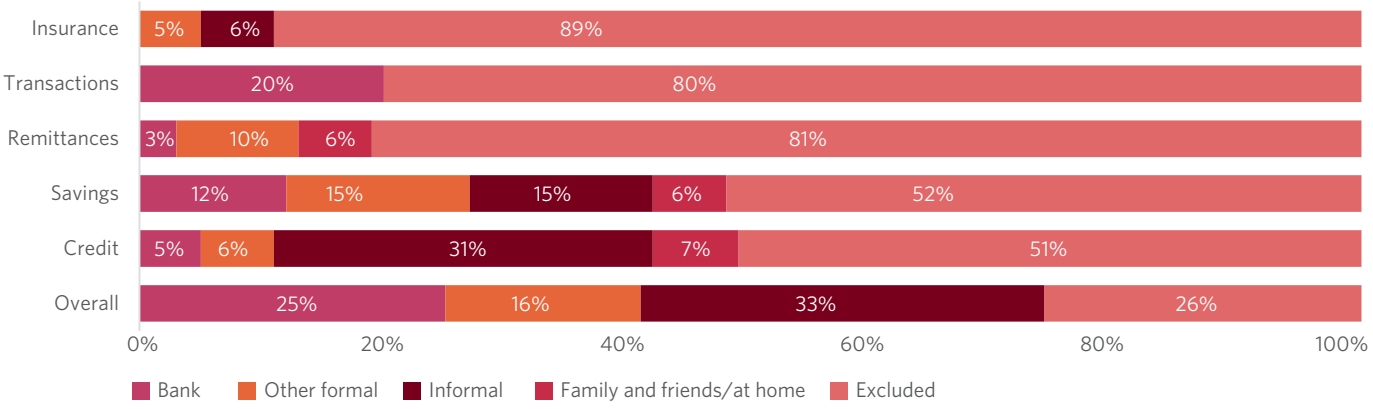


Figure 76: Irregular earners: access strand across product markets
Source: FinScope, 2014.

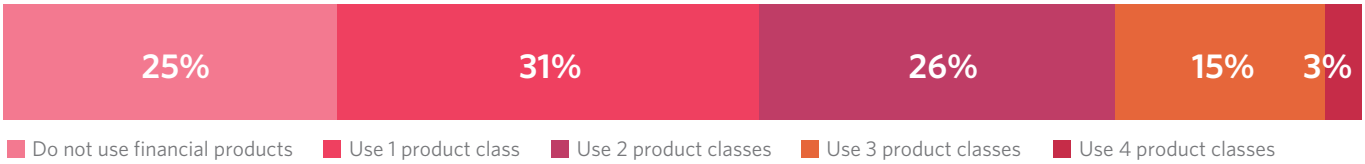


Figure 77: Depth of financial service usage
Source: FinScope, 2014.

Payments products, remittances and digital transactions, and insurance are notably low for this target market. Low and irregular incomes will reduce the ability of the target market to commit to regular account payments or premiums. Furthermore, in this highly cash-based economy there is little incentive to take on the additional cost of a transactional account.

Depth of financial service usage. Of all irregular earners, 44% use more than one financial product. Figure 77 shows that 31% use only one financial service (17% of which use credit services). Of this target market segment, 11% use a combination of credit and savings, while 10% use the combination of credit, saving and payment financial services.

Main financial service needs
Irregular earners are characterised by low and irregular incomes. The target market's income profile means that it is very difficult for this target market segment to save enough to cope with emergencies or pay for investments and other expenses (e.g. education fees for children).

This target market needs financial products that help people to manage these challenges in an affordable and accessible manner. This includes savings, credit and potentially remittances. Less potential exists for insurance and transaction products, unless these are designed in a targeted manner. Irregular earners require financial services that help them to smooth consumption, mitigate risk and store their irregular incomes safely.

Farmers

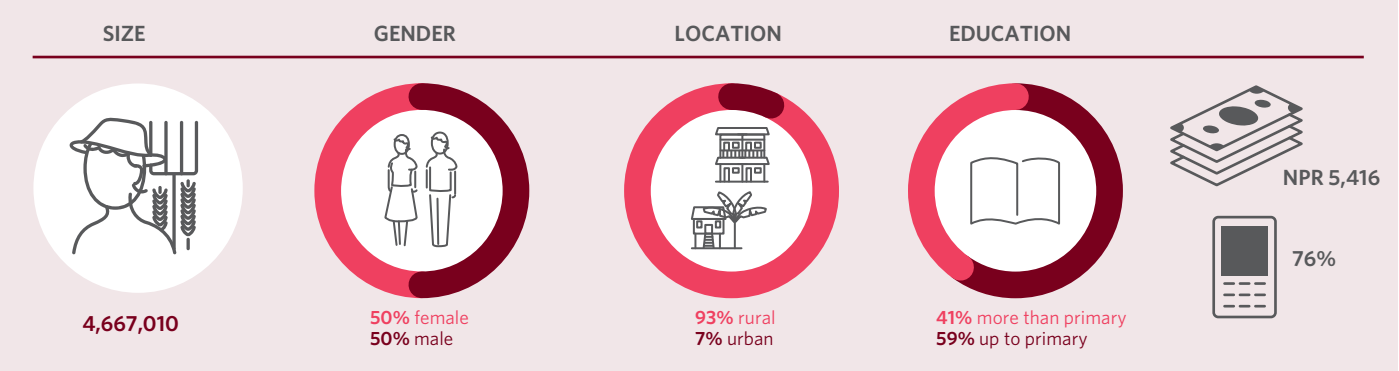


Figure 78: Farmers – key indicators
Source: FinScope, 2014.

Large target segment with low levels of income. Farmers are the largest target market segment (32% of the adult population) with the second lowest level of average monthly income (NPR 5,416: US$ 55) and with the majority rurally based. However, focusing solely on the level of monetary income is not the most accurate measure for the farmers segment because the majority consume rather than sell their produce, thereby augmenting their livelihoods. Of the farmers segment, 75% are subsistence farmers (3,473,704 farmers) while 25% are trading farmers (1,147,070 farmers).

Furthermore, 14% of farmers receive additional monetary incomes through remittance. Even with augmentation, farmers' incomes are low due to low levels of agricultural productivity (quality and quantity).

Farmers face many obstacles that serve to keep incomes down. The majority of farmers are located in rural areas, where farming inputs are irregularly available (Ghimire, June 2008). A lack of basic storage and packaging facilities means that farmers cannot store their produce for very long and are consequently unable to choose to delay the sale of their produce for more favourable prices. Poor road connectivity in rural areas and limited market access, which restrict options for selling their produce, combined with low education levels and concomitant low skills levels among the members of this target market segment all serve to keep incomes down.

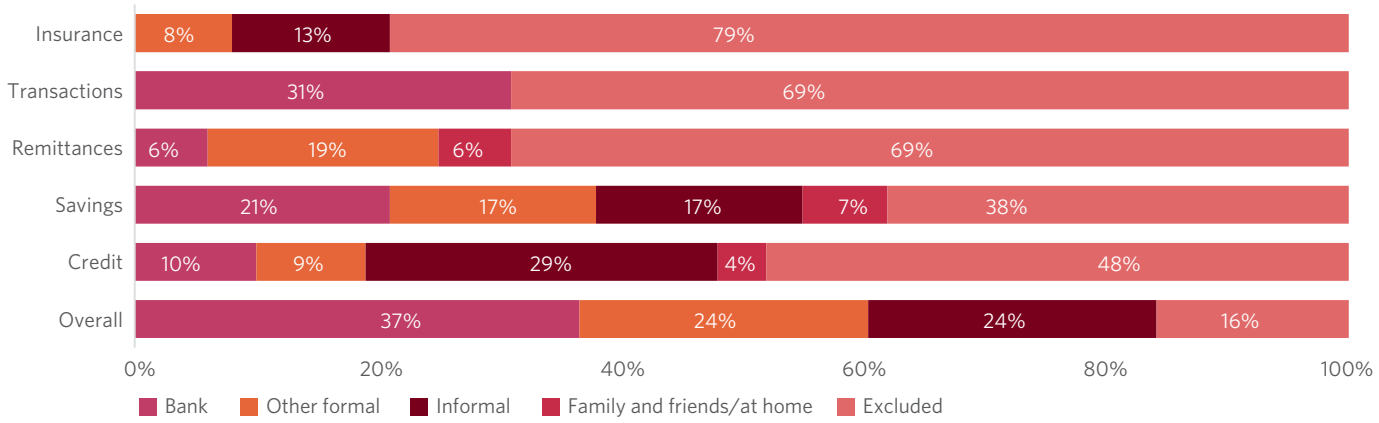


Figure 79: Farmers: access strand across product markets

Source: FinScope, 2014.

"The young generation these days do not want to work in the farms. They consider farming low-level work. Many of the males have left for foreign employment, including my two sons. There is an acute shortage of labour so my two daughters-in-law and my wife help me on the farm. Farming is difficult because quality seeds and fertilisers are not available on time; hence even after the hard work we put in, the output is low in comparison to the effort. If we get a good harvest we are unable to get a good value because we do not have storage. So we have to sell at whatever price we get or risk not earning anything." (Farmer, male, aged 53)

Farmer segment has equal gender participation. FinScope (2014) data indicates that farmers are the only target market with an equal gender split. It is worth noting that gender participation is close to the population average: males constitute 49% of the farmer target market segment (compared to the population average of 47%), while females constitute 50% of this target market segment (compared to the population average of 53%) (FinScope, 2014).

The high level of subsistence farming prevalent in the agriculture sector of Nepal, as already discussed, drives a culture of involving the whole family in farming, which also leads to gender participation close to the population average.

High levels of inclusion, with informal and family and friends as key providers. Figure 79 provides a breakdown of access to financial services by farmers. Only 16% of this target market is excluded from financial services. Of the adults that are financially included, there is relatively lower formal uptake in comparison to informal providers. As with the other low-income target market segments, family and friends are a more significant provider, particularly in terms of remittances and savings.

The key products for farmers are savings and credit: when overlaps are included, 27% of farmers have access to formal savings, but savings uptake in the informal channel is significant with 37% of farmers using informal channels for saving.

Half of the farmers make use of payments products, which is driven by a third of farmers taking up remittance and transactions, respectively.

Overall, insurance penetration is high relative to the other target market segments, although the formal insurance channel is low (8% of farmers) compared to the 13% of farmers that use informal insurance only (and the further 2% that make use of both formal and informal insurance).

Informal credit available on a normal or contract farming basis. Similarly, 19% of farmers have access to formal credit, but the uptake of informal credit is higher (33%) for this target market segment.

Among the informal providers, local merchants and other traditional moneylenders are the most popular source of agriculture lending in rural Nepal. Financial services provided through informal channels are more accessible in terms of eligibility requirements, flexible repayment arrangements and convenience of location, although the downside is high interest rates and unwarranted attachment of collateral.

Loans are generally taken by farmers for consumption and social purposes rather than productive purposes.

"The loan I have taken was to meet the wedding expenses of my youngest daughter; in return I was required to pay NPR 10 for every NPR 100 borrowed." (Farmer, male, aged 47)

In addition to the general credit uptake already discussed, credit taken by members of this target market segment is sometimes linked to an informal contract farming arrangement. Contract farming is defined as agricultural production carried out according to a prior agreement in terms of which the farmer commits to producing a given product in a given manner and the buyer commits to purchasing it. Often the buyer provides the farmer with technical assistance, seeds, fertiliser and other

inputs on credit and offers a guaranteed price for the output (Minot, 2007). Usually in such a scenario the farmer takes a loan/s from traders, merchants, wholesalers or retailers to whom the farmer normally sells the produce, in return for a specified portion of the harvest at a pre-determined rate, irrespective of market prices at the time of harvest. (FinScope 2014 indicates that the majority of farmers sell their produce to wholesalers – 25%; retailers – 15%; and agents – 10%.)

"I am in contact with a trader from Kathmandu Valley. He provides me with the seeds and fertilisers and insecticides on loan. I have to sell him about 75% of my produce and he pays me in cash after deducting his investment in seeds, fertilisers and insecticides. The price of my products are determined by the market price at the vegetable market in Kathmandu." (Farmer, male, aged 43)

Depth of usage is moderate. Only 8% of farmers use all four formal financial services. However, 60% of all farmers use two or more formal products. The most popular combination is savings and payments, which constitute 14% of the total usage of financial services (FinScope, 2014).

Segmentation analysis of farmers

According to FinScope, 31% of the adult population is involved in farming activities as their primary income-generating activity. Many other adults (48%) use farming as a means of supplementing their incomes.

Farmers can be classified into two groups: subsistence farmers and trading framers:

- Subsistence farmers consume most of their produce, leaving little or nothing to be marketed.
- Trading farmers, rather than consuming their produce, sell most of it; as a result they have more access to resources.

Of the total farmer population, there are 3,473,704 subsistence farmer (75% of the farmer population) and 1,147,070 trading farmers (25% of the farmer population). Trading farmers have higher education levels than subsistence farmers (43% of trading farmers have a secondary education, while only 37% of subsistence farmers have a secondary education).

Marginal financial access difference between subsistence and trading farmers. In line with the more commercial nature of trading farmer enterprises, it could be anticipated that these farmers would have a substantially higher monetised income than their subsistence counterparts. However, this has not translated into a difference in financial services uptake; the trading farmers' level of formal financial usage is only marginally higher than that of subsistence farmers (as shown in Figure 80). In particular, 62% of trading farmers have access to formal financial services (compared to just over 60% of subsistence farmers).

Average uptake of credit. FinScope (2014) indicates that subsistence farmers have higher access to informal credit (30% of subsistence farmers versus 26% of trading farmers), whereas the reverse is true for access to formal credit (24% of trading farmers versus 18% of subsistence farmers). Overall, credit from formal providers for trading farmers is higher compared to the population average of 18%, whereas both farming groups fall below the population average of 30% of adults for informal credit. While there is evidence of access to credit, this covers just over half of each target market; this is particularly worth noting in the case of trading farmers, who show potential for future income streams from the sale of their crops (and therefore could support the repayment of credit).

Main financial service needs

Although FinScope has classified farmers as a separate target market segment, it should be noted that adults in other target market segments supplement their incomes through farming activities. Hence, financial service interventions targeted at 'those who farm' would have the potential to benefit a larger share of the adult population than simply those who fall squarely into the farmers target market segment.

When designing financial products for farmers, their unique seasonal cash flow must be considered. In addition, there exists a day-to-day need to cover consumption. Therefore, farmers need to be able to smooth their finances to ensure money is available when they need it.

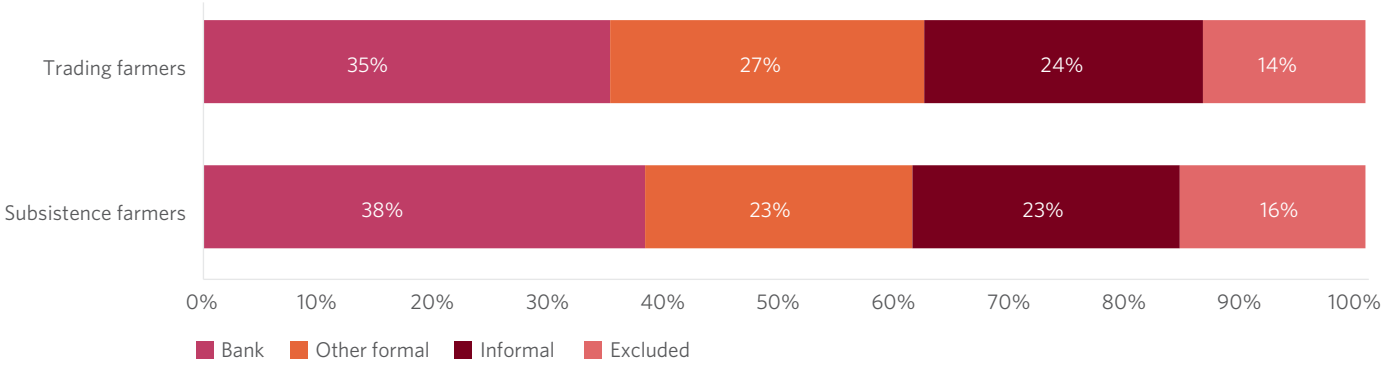


Figure 80: Financial access per farmer category (trading versus subsistence)

Source: FinScope, 2014.

Furthermore, financial products that enable farmers to store income until they need to purchase inputs would assist them to invest in future income flows.

Remittance and credit products that can assist with supplementing income gaps are also needed. In this respect, the two types of farmers active in Nepal – subsistence and trading farmers – is worth noting, because they show different drivers with regard to monetising their farming income. The trading group, which is focused on producing items for sale, shows greater potential for earning income streams from capital investment to assist with repayment of any credit used for such purposes; they are thus a good focus area for productive credit.

Finally, this target market segment is highly vulnerable to risk from external factors that can affect production, and therefore could benefit from risk-mitigation products.

Dependants

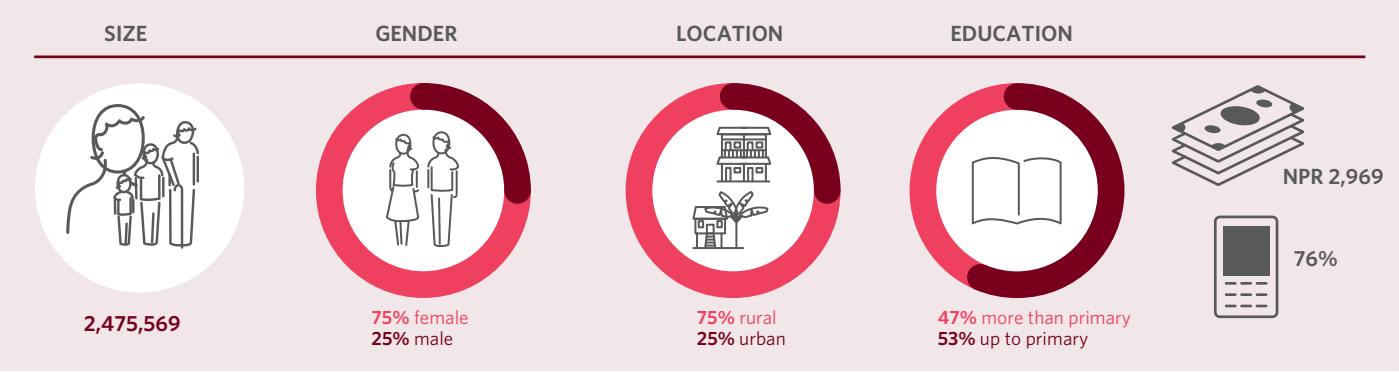


Figure 81: Dependants – key indicators

Source: FinScope, 2014.

Young, slightly better educated, rural and mostly female. The dependants target market segment is substantial, at 17% of the total adult population.

Dependants have the third highest education level of all the target market segments, although 53% of this target market segment have primary school or lower education levels.

This target market is strongly skewed towards females (75% of dependants are female, versus the population average of 53%).

The dependants target market segment has an average age of 36 years, which is below the population average age of 38.

Despite being largely rural (75% of dependants in rural areas), this segment has a higher-than-average number of dependants in urban areas (25% of the target market).

Additionally, dependants have an unusual dominance in hill areas (92% of dependants in hill areas versus the population average of 44%).

Low-income levels driven by dependency on others. The dependants target market segment is the lowest earning of the segments, with an average income of NPR 2,969 (US$ 30) which is less than half the population average of NPR 6,669 (US$ 68). The low level of income for this segment is largely driven by dependency on others for main source of income. Dependants, by virtue of their dependence on others, are usually provided with the amount of income that matches their financial needs and therefore seldom have much surplus of funds beyond these needs.

"My son works as a teacher in the government school. I am unable to do any work because of my back. I depend on my son for income. My son gives me some money every month which I save, most of it in my trunk and also a small portion of it in mothers' saving group. I do not have to spend on food because my son pays for it all. It's only the clothes and jewellery I have to spend money on." (Dependant, female, aged 79)

Lowest access to financial services. As shown in Figure 82, this target market has relatively low access to financial services, with only 67% of dependants being financially included. This is the lowest level of inclusion out of all the target market segments.

Dependants have the highest levels of access via informal channels, although formal channels are still significant with 29% and 31% of the target market taking up financial services from banks and other formal providers, respectively.

Savings and payments are key product markets for dependants. This is significant given their low income levels, which leave little surplus for saving or potentially covering credit payments that are not anticipated by the benefactor who provides their income.

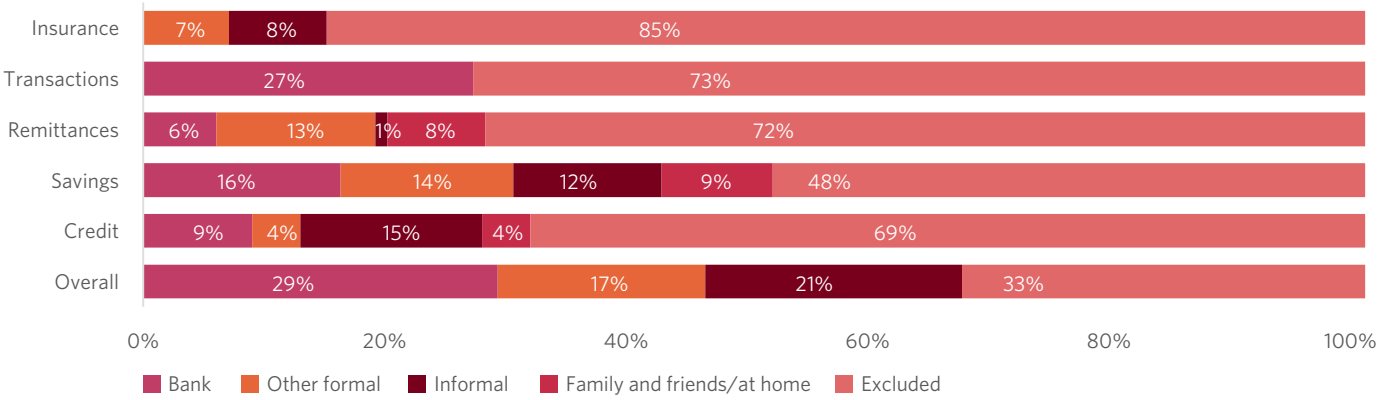


Figure 82: Dependants: access strand across product markets
Source: FinScope, 2014.

In terms of uptake of financial services, informal providers dominate credit provision, while both informal and formal play a key role in savings (e.g. 26% of dependants are saving informally, overlaps included).

Payment products are accessed by a third of the group.

When overlaps are taken into account, family and friends are the key provider for remittance (18% of dependants), while other formal (14%) and bank (6%) still play a significant role.

Depth of financial service usage. Of the dependants segment, 44% use more than one financial product (see Figure 83). The most used financial service is savings, with 12% of dependants using savings. The most common combination of financial services is savings and payment, used by 11% of dependants.

Main financial service needs
The nature of the income of dependants has led to their position as the poorest of the target market segments. Income received is usually only sufficient to meet their daily needs.

The main financial service need of this segment is consumption smoothing, along with risk mitigation and investment commensurate with their low incomes. To make these options feasible at the dependants' income level, financial products would need to be tailored for low values and be affordably priced.

In particular, affordable low-value savings, and cheap, reliable payments products for income receipt would be beneficial.

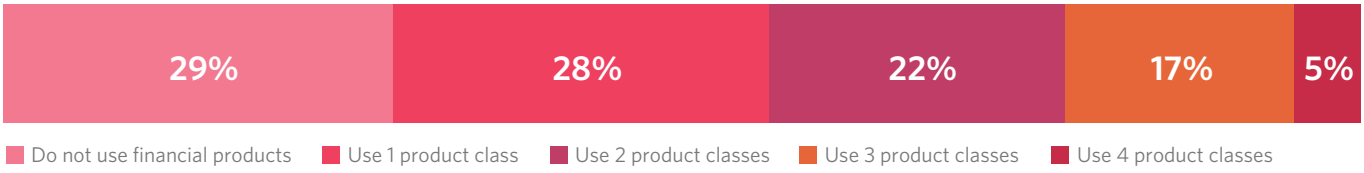


Figure 83: Depth of financial service usage
Source: FinScope, 2014.

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Appendix 1

List of Financial Inclusion-related Donor Projects

#	Key project/ initiative title	Donor	Scope (FI product)	Project description, objectives and output	Aid modality	Type of assistance	Status	Currency	Budget	Project timelines		Implementing partner/sector	Website
										Date of agreement effective	Date of planned completion		
1	Improving Access to Finance Sector Development Program	ADB	Capacity building	The proposed programme is to develop a market-oriented effective microfinance sector to improve access to finance for the poor and low-income population with a special focus on enhanced outreach in hill and mountain areas.	Technical assistance	Grant/loan	Closed	US$	485,179.27	Jan-11	Jun-14	Ministry of Finance	www.adb.org/projects/40558-012/main
2	Rural Finance Sector Development Cluster Program (Sub-program II)	ADB	Capacity building	Review of the sub-program I and develop an assistance plan for sub-program II.	Technical assistance	Grant/loan	Closed	US$	400,000.00	Dec-08	Oct-10	Ministry of Finance	www.adb.org/projects/36169-062/main
3	Rural Finance Sector Development Cluster Program (Sub-program 2)	ADB	Capacity building	The programme is the second of two sub-programmes under the Cluster Program. The objective of the programme is to improve the soundness, efficiency, and outreach of the Borrowers rural finance sector, through policy, legal, regulatory and institutional reform.	Technical assistance	Grant/loan	Ongoing	US$	68,984,499.04	Jun-10	Dec-14	Ministry of Finance	www.adb.org/projects/36169-023/main
4	Capital Markets and Infrastructure Finance Support Project	ADB	Capacity building	Aiming to bridge gaps in infrastructure financing.	Direct project support	Grant	Ongoing	US$	1,320,000.00	Apr-11	Jul-17	Ministry of Finance	www.adb.org/projects/43490-013/main
5	Sakchyam Access to Finance	DFID	Capacity building	The project aims to work with the public and private sectors to leverage access and facilitate financial sector development in Nepal for small and medium enterprises (SMEs) and for poor people, with a focus on the Mid- and Far Western regions.	Direct project support	Grant	Ongoing	US$	29,600,000.00	Jul-14	Jul-19	Louis Berger and three other organisations	www.sakchyam.com.np/

#	Key project/ initiative title	Donor	Scope (FI product)	Project description, objectives and output	Aid modality	Type of assistance	Status	Currency	Budget	Project timelines		Implementing partner/sector	Website
										Date of agreement effective	Date of planned completion		
6	Sustainable Access to Finance and Livelihoods in Nepal	DFID	Capacity building	The project works to provide access to affordable financial services, which will help poor households plan for routine expenses, cope with sudden external shocks, better cover unanticipated expenses, and also facilitate better access to stable and productive activities.	Direct project support	Grant	Closed	GBP	2,200,000.00	Aug-13	Jul-15	The Blueberry Hill Charitable Trust	http://samriddhapahad.org/project.php
7	Enhancing Access to Financial Services (EAFS)	UNCDF/ UNDP	Credit	This project supported the microfinance institutions through technical assistance and grant support to provide rural women with access to formal savings and credit services in the many areas of rural Nepal where access to such services was non-existent or limited.	Technical assistance	Grant	Closed	US$	3,000,000.00	Nov-08	Dec-12	NRB along with 17 financial service providers	www.np.undp.org/content/nepal/en/home/operations/projects/closed-projects/poverty-reduction/eafs.html
8	Establishment of a Business Service Centre for Women's Micro and Small Enterprises in Nepal	European Union	Credit	Target groups are the poor and disad-vantaged women, and women en-trepreneurs. Focuses on six areas surrounding the capital. The main objective is to reduce poverty – to contribute to poverty reduction through women's par-ticipation, and the creation and develop-ment of micro and small enterprises (MSEs).	Direct project support	Grant	Closed	EUR	520,802.44	Mar-08	Feb-12	Associazione Italiana Donne Per Lo Sviluppo	http://eeas.europa.eu/delegations/nepal/projects/list_of_projects/133415_en.htm

#	Key project/ initiative title	Donor	Scope (FI product)	Project description, objectives and output	Aid modality	Type of assistance	Status	Currency	Budget	Project timelines		Implementing partner/sector	Website
										Date of agreement effective	Date of planned completion		
9	Rural Access Program (RAP) 3	DFID	Capacity building	The overarching purpose of RAP 3 is to boost income and improve quality of life for the residents of some of Nepal's poorest districts. This is being achieved through the generation of employment, access to markets, and access to economic opportunities. Prioritising sustainability in each of these components helps ensure that all ensuing development is resilient to economic, political and environmental insecurity.	Direct project support	Grant	Ongoing	NPR	750,000.00	Oct-15	Sep-16	IMC Worldwide	
10	Access to Finance (A2F)	UNDCF/ Danida	Capacity building	A2F aims to provide support to financial institutions to improve their technical knowledge in agricultural finance and expand their products and services to rural areas and agricultural activities.	Technical assistance	Grant	Ongoing	US$	8,000,000.00	Mar-14	Mar-19	NRB	www.uncdf.org/en/content/access-finance-a2f-officially-starting-nepal

Appendix 2

List of in-country consultations

Category	Institution	Place	Member	Position
Class A	Agricultural Development Bank Ltd	Kathmandu	Anil Kumar Upadhyay	Deputy General Manager
Class A	Agricultural Development Bank Ltd	Kathmandu	Lila Prakash Sitaula	
Class A	Global IME	Kathmandu	Janak Sharma Poudyal	Sr Deputy CEO
Class A	Laxmi Bank	Kathmandu	Ajaya Bikram Shah	
Class A	Laxmi Bank	Kathmandu	Jiwan Limbu	Chief Technology Officer
Class A	Laxmi Bank	Kathmandu	Sudesh Khaling	CEO
Class A	Nabil Bank	Kathmandu	Gyaneshwar Acharya	Head: SME Banking & MF
Class A	Nabil Bank	Kathmandu	Niraj Sharma	Head: Cards & e-Banking
Class A	Nabil Bank	Kathmandu	Sashin Joshi	CEO
Class A	Nepal Investment Bank Ltd (NIBL)	Kathmandu	Bijendra Suwal	Deputy General Manager
Class A	Prabhu Bank	Kathmandu	Ashok Sherchan	CEO
Class A	Prime Life Nepal	Kathmandu	Kushal Karki	Corporate Business
Class A	Prime Life Nepal	Kathmandu	Prayash Shrestha	Head: Corporate Business
Class A	Rastriya Banijya Bank Ltd	Kathmandu	Krishna Prasad Sharma	CEO
Class A	Rastriya Banijya Bank Ltd	Kathmandu		
Class A	Sanima Bank	Kathmandu	Chandan Tamrakar	Relationship Manager
Class A	Standard Chartered	Kathmandu	Joseph Silvanus	CEO
Class B	Kanchan Development Bank	Dadeldhura		
Class B	Kanchan Development Bank	Kathmandu	Maniraj Bhatta	Branch Manager
Class B	Business Universal Development Bank Ltd	Kathmandu	Manohar KC	CEO
Class B	Kailash Bank	Kathmandu	Krishna Raj Lamichane	
Class B	Narayani National Finance	Kathmandu	Naresh Singh Bohra	CEO
Class B	NIDC Development Bank	Kathmandu	Rabindra Raj Panta	Deputy Director
Class B	NIDC Development Bank	Kathmandu	Shekhar Bhattarai	Acting Director
Class B	NIDC Development Bank	Kathmandu	Shivjee Roy Yadav	CEO
Class B	NIDC Development Bank	Kathmandu		
Class B	Nirdhan Utthan Bank Ltd	Kathmandu	Bhoj Raj Bashyal	General Manager
Class B	Nirdhan Utthan Bank Ltd	Kathmandu	Janardan Dev Pant	CEO
Class B	Mahakali Development Bank	Mahendranagar		
Class B	City Development Bank	Pokhara	Bishwo Mohan Adhikari	CEO
Class B	City Development Bank	Pokhara	Kamal Kumar Pradhan	Credit Risk Officer
Class B	Garima Bikas Bank Ltd	Pokhara	Govinda Prasad Dhakal	CEO
Class B	Garima Bikas Bank Ltd	Pokhara	Ishwori Dhakal	
Class B	Muktinath Bikas Bank Ltd	Pokhara	Govinda Bahadur Raut	Head: Microfinance Department
Class B	Muktinath Bikas Bank Ltd	Pokhara	Til Bahadur Gurung	Chief: Modern Banking Division
Class B	Reliable Development Bank Ltd	Pokhara	Niraj Shrestha	Deputy CEO
Class B	Reliable Development Bank Ltd	Pokhara	Dipendra Kadariya	Chief Operating Officer
Class C	ICFC Finance Ltd	Kathmandu	Sunil Pant	Deputy CEO

Category	Institution	Place	Member	Position
Class C	Synergy Finance Ltd	Kathmandu	Hebendra Shakya	Senior Officer
Class C	United Finance Ltd	Kathmandu	Sunanda B Shrestha	CEO
Class C	Srijana Fiannce Ltd	Biratnagar		
Class C	Fewa Bikas Bank Ltd	Pokhara	Taranath Lamsal	Assistant CEO
Class C	Om Finance	Pokhara		
Class C	Pokhara Finance Ltd	Pokhara	Yub Raj Bohora	Compliance Officer/ Recovery Head
Class D	Kishan Micro Bitiya Sansta	Dadeldhura		
Class D	Nepal Grameen Bikas Bank	Dadeldhura		
Class D	Nepal Grameen Bikas Bank	Biratnagar		
Class D	Nepal Grameen Bikas Bank	Pokhara		
Class D	Chhimek Laghubitta Bikas Bank Ltd	Kathmandu	Ramchandra Joshee	CEO
Class D	Kisan Micro Finance	Kathmandu		
Class D	Purwanchal Grameen Bikas Bank Ltd	Kathmandu	Muna Shrestha	Department Chief
Class D	Rural Microfinance Development Centre	Kathmandu	Ram Dayal Rajbansi	Assistant General Manager
Class D	Sana Kisan Bank Ltd	Kathmandu	Jalan Kumar Sharma	CEO
Class D	Sana Kisan Bank Ltd	Kathmandu	Jhalendra Bhattarai	Senior Manager
Class D	Sana Kisan Bank Ltd	Kathmandu	Krishna Prasad Lamichhane	Program Coordinator
Class D	Swabalamban Laghubitta Bikas Bank Ltd	Kathmandu	Naresh Man Pradhan	CEO
Class D	Vijaya Laghubitta Bittiya Sanstha Ltd	Kathmandu	Basanta Raj Lamsal	Managing Director
Cooperative	Indrawati Savings and Credit Cooperative Ltd	Banke		
Cooperative	Mahila Jyotikunja Savings and Credit Cooperative Ltd	Banke		
Cooperative	Shree Holika Savings and Credit Cooperative Ltd	Banke		
Cooperative	Janakalyankari Savings and Credit Cooperative	Bardiya		
Cooperative	Shiva Shankar Savings and Cooperatives	Dadeldhura		
Cooperative	Him Shikhar Savings and Credit Cooperative	Dhangadi		
Cooperative	Navajeevan Savings and Credit Cooperative	Dhangadi		
Cooperative	Baudha Grameen Multi-purpose Cooperative	Kathmandu	Bishal KC	CEO
Cooperative	Bheri Karnali Savings and Credit Cooperative	Kathmandu	Bhakta Bahadur Buda	Manager
Cooperative	Dev Nari Saving Cooperative	Kathmandu		
Cooperative	Dev Savings & Credit Cooperative	Kathmandu		
Cooperative	Him Shikhar Savings and Credit Cooperative	Kathmandu	Mahendra Shahi	Promoter
Cooperative	Indrawati Savings and Credit Cooperative Ltd	Kathmandu		General Manager
Cooperative	Janakalyankari Savings and Credit Cooperative	Kathmandu		Treasurer
Cooperative	Lalima Credit & Cooperative	Kathmandu		
Cooperative	Mahila Jyotikunja Savings and Credit Cooperative Ltd	Kathmandu		
Cooperative	Milan Multi-purpose Cooperative	Kathmandu		
Cooperative	Navajeevan Savings and Credit Cooperative	Kathmandu	Shiva Poudel	Manager
Cooperative	Pratab Savings & Cooperative Ltd	Kathmandu		
Cooperative	Rhinestar Saving and Credit Cooperative	Kathmandu		
Cooperative	Shree Holika Savings and Credit Cooperative Ltd	Kathmandu	Devendra Bhattarai	Manager
Cooperative	Shuva Ganapati Saving & Credit Cooperative Ltd	Kathmandu		

Category	Institution	Place	Member	Position
Cooperative	National Cooperative Bank Ltd	Lalitpur		
Cooperative	Pragati Savings & Credit Cooperative Ltd	Lalitpur		
Cooperative	Sagarmatha Savings & Cooperative	Lalitpur		
Cooperative	Mega Cooperative Ltd	Mahendranagar		
Cooperative	Shree Bhamkeshwor Savings and Credit Cooperative	Mahendranagar (Shishaiya)		
Cooperative	Udaya Multi-purpose Cooperative	Mahendranagar		
Cooperative	Mitrank Savings and Cooperative Ltd	Makwanpur		
Cooperative	Ashirvad Savings and Credit Cooperative Ltd	Parsa	Santosh Lal Karna	Manager
Cooperative	Narayani Savings & Credit Co. Ltd	Parsa	Kanahiya Singh	Staff
Cooperative	Surya Savings & Credit Co. Ltd	Parsa	Mukesh Singh	
Cooperative	Pokhara Royal Cooperative Society Ltd	Pokhara	Bhim Gurung	Managing Director
Cooperative	Royal Multi-purpose Cooperatives	Pokhara		
Cooperative	Shree Mahabharat Krishi Cooperative Ltd	Sindhuli		
Cooperative	Baudha Grameen Multi-purpose Cooperative	Surkhet		
Cooperative	Bheri Karnali Savings and Credit Cooperative	Surkhet		
Cooperative	Rhinestar Savings and Credit Cooperative	Surkhet		
Cottage and Small industry	National Productivity and Economic Development Centre	Kathmandu	Anjana Tamrakar	General Manager
Development partners	Sakchyam – Access to Finance	Kathmandu	Bandhu Ranjan	Programme Support Manager
Development partners	Sakchyam – Access to Finance	Kathmandu	Jhank Narayan Shrestha	Research and M&F Director
Development partners	UNCDF	Kathmandu	Jaspreet Singh	
Development partners	UNNATI – Access to Finance	Kathmandu	Fani Lal Chaudhary	Team Leader
Industry	Pro-biotech Industries	Kathmandu	Anand Bagaria	
Insurance	Met Life	Kathmandu	Arun Basnet	Manager
Insurance	Met Life	Kathmandu	Bibhu Rawal	Assistant Manager
Insurance	Met Life	Kathmandu	Nirmal Kajee Shrestha	Chief Distribution Officer
Insurance	Nepal Life Insurance	Kathmandu	Agam Mukhia	Assistant General Manager
Insurance	Nepal Life Insurance	Kathmandu	Vivek Jha	
Insurance	NLG Insurance Company Ltd	Kathmandu	Vijay B Shah	CEO
Insurance	Rastriya Beema Sansthan	Kathmandu	Ashwini Kumar Thakur	Administrator
Insurance	Rastriya Beema Sansthan	Kathmandu	Pramod Bhattarai	Chief Manager
Insurance	LIC (Nepal) Insurance Co. Ltd	Parsa	Sujit Thakur	Manager
Payment gateway	SCT	Kathmandu	Rabindra Malla	CEO
Pension fund	Employees Provident Fund	Kathmandu	Krishna Prasad Acharya	
Private stakeholder	Smart Technologies Pty Ltd	Kathmandu	Rabindra Bahadur Malla	Managing Director
Private stakeholder	IME Remittance	Parsa	Rajendra Upadhyay	Promoter
Private stakeholder	Finaccess	Kathmandu		
Regulator	Department of Cooperatives	Kathmandu		
Regulator	Ministry of Cooperatives and Poverty Alleviation	Kathmandu	Narayan Prasad Gyawali	Deputy Registrar
Regulator	Beema Samiti	Kathmandu	Rajkumar Aaryal	
Government	Ministry of Finance	Kathmandu		

Category	Institution	Place	Member	Position
Regulator	Nepal Rastra Bank – Bank Supervision Department	Kathmandu		
Regulator	Nepal Rastra Bank – Payments Supervision/Regulation Department	Kathmandu		
Regulator	Nepal Rastra Bank	Kathmandu	Ashok Paudel	Acting Director
Regulator	Nepal Rastra Bank	Kathmandu	Binod Atreya	Executive Director: Micro Finance, Promotion and Supervision Department
Regulator	SEBON	Kathmandu	Niraj Giri	
Remittance	IME Group	Kathmandu	Chandra Prasad Dhakal	Executive Director
Remittance	IME Group	Kathmandu	Hem Raj Dhakal (Ramu)	Managing Director
Remittance	IME Group	Kathmandu	Suman Pokharel	CEO
FINGO	Jeevan Bikas Samaj	Kathmandu	Damodar Regmi	Senior Manager
FINGO	Jeevan Bikas Samaj	Kathmandu	Om Bhandari	
FINGO	Jeevan Bikas Samaj	Kathmandu	Torna Basnet	
FINGO	Jeevan Bikas Samaj	Kathmandu	Tulsa Kalfe	

Focus-group discussions

Category	Institution	Place	Member	Position
Associations	Federation of Nepal Cottage & Small Industries	Kathmandu	Bishnu Bahadur Luitel	Secretary General
Associations	Federation of Nepal Cottage & Small Industries	Kathmandu	Hem Kumar Rai	Executive Director
Associations	Federation of Nepal Cottage & Small Industries	Kathmandu	Shyam Prasad Giri	Senior Vice President
Associations	FGD Bankers Association	Kathmandu		
Associations	Nepal Federation of Savings and Credit Cooperative Unions	Kathmandu	D B Basnet	
Associations	Nepal Federation of Savings and Credit Cooperative Unions	Kathmandu	Paritosh Paudyal	
Associations	Nepal Federation of Savings and Credit Cooperative Unions	Kathmandu	Rishi Raj Ghimire	Chairman
Associations	Nepal Federation of Savings and Credit Cooperative Unions	Kathmandu	Shivajee Sapkota	CEO
Associations	Nepal Micro Finance Bankers Association	Kathmandu	Basanta Lamsal	
Associations	Nepal Micro Finance Bankers Association	Kathmandu	Naresh Man Pradhan	
Associations	Nepal Micro Finance Bankers Association	Kathmandu	Prakash Raj Sharma	
Associations	Nepal Micro Finance Bankers Association	Kathmandu	Ram Chandra Joshi	
Associations	Nepal Micro Finance Bankers Association		Dr Sumitra Manandhar	
Associations	Nepal Multi-purpose Central Cooperative Union	Kathmandu	Sandhya Shrestha	Manager
Development partners	Samriddha Pahad UK	Kathmandu	Sanjeev Neupane	Programme Manager
Development partners	MEDEP	Kathmandu	Ramji Neupane	
Development partners	Mercy Corps	Kathmandu	Mahendra Shahi	
Development partners	World Bank Group	Kathmandu	Santosh Pandey	
Development partners	World Bank Group	Kathmandu	Saurav Rana	
Development partners	UNCDF	Kathmandu	Feisal Hussein	
Development partners	DP Cell	Kathmandu	Anil Chandrika	
Development partners	UNCDF	Kathmandu	Jaspreet Singh	
Development partners	USAID	Kathmandu	Anita Mahat Rana	
Development partners	UNDP/MEDEP		Gokul Pyakurel	
Development partners	Embassy of Denmark	Kathmandu	Aayush Rai	

Category	Institution	Place	Member	Position
Development partners	DFID	Kathmandu	Rabi Rayamajhi	
Development partners	UNCDF	Kathmandu	Ujjwal Pokhrel	
Development partners	UNNATI	Kathmandu	Shankar Tomatta	
Development partners	UNNATI	Kathmandu	Sunil Prasad Dhital	
Government	Office of Company Registrar	Kathmandu	Prem Kumar Shrestha	
Government	Ministry of Finance	Kathmandu	Chiranhivi Khanal	
Government	Ministry of Finance	Kathmandu	Surya P Acharya	
Government	Central Bureau of Statistics	Kathmandu	Promod Raj Regmi	
Government	Ministry of Finance	Kathmandu	Baikuntha N Sharma	
Regulator	Nepal Rastra Bank	Kathmandu	Bhisma Raj Dhungana	
Regulator	Nepal Rastra Bank	Kathmandu	Trilochau Pangeni	
Regulator	Nepal Rastra Bank	Kathmandu	Bhubanesh Pant	
Regulator	Nepal Rastra Bank	Kathmandu	Nara Bahadur Thapa	
Regulator	Nepal Rastra Bank	Kathmandu	Narayan Pd. Paudel	
Regulator	Nepal Rastra Bank	Kathmandu	Khyam Narayan Dhakal	
Regulator	Nepal Rastra Bank	Kathmandu	Bam Dev Sigdel	
Regulator	Nepal Rastra Bank	Kathmandu	Jhalak Acharya	
Regulator	Nepal Rastra Bank	Kathmandu	Upendra Kumar Paudel	
Regulator	Nepal Rastra Bank	Kathmandu	Shiva Regmi	
Regulator	Nepal Rastra Bank	Kathmandu	Revati Pd. Nepal	
Regulator	Nepal Rastra Bank	Kathmandu	Hari Pd. Kaphle	
Regulator	Nepal Rastra Bank	Kathmandu	Balaram Parajuli	
Regulator	Nepal Rastra Bank	Kathmandu	Ram Hari Dahal	
Regulator	Nepal Rastra Bank	Kathmandu	Jhalak Sharma Acharya	Director
Regulator	Nepal Rastra Bank	Kathmandu	Mahesh Bhattarai	Executive Director
Regulator	Nepal Rastra Bank	Kathmandu	Narayan Prasad Paudel	Executive Director
Regulator	Nepal Telecommunications Authority	Kathmandu	Purushottam Khanal	
Regulator	Beema Sansthan	Kathmandu	Fatta Bahadur KC	
Development partner	ILO		Dhiraj Karki	
Development partner	UNDP		Heema Khadka	
Development partner	Samriddhi Pahad		Rishi Wagle	
Development partner	GIZ INCLUDE		Archana Rai	
Development partner	European Union		Mim Hamal	
Development partner	World Bank		Jyoti Pandey	
Development partner	Sakchyam – Access to Finance		Jhank N Shrestha	
Development partner	DP Cell		Anil Chandrika	
Private stakeholder	Nepal Investment Bank Ltd		Bijendra Suwal	
Private stakeholder	United Finance Ltd		Ishwor Pokharel	
Private stakeholder	Sana Kisan Bikas Bank Ltd		Jalan Kumar Sharma	

Category	Institution	Place	Member	Position
Private stakeholder	Sana Kisan Bikas Bank Ltd		Jhalendra Bhattarai	
Private stakeholder	Sana Kisan Bikas Bank Ltd		Liladhar Dhital	
Private stakeholder	Sana Kisan Bikas Bank Ltd		Krishna Pd. Lamichhane	
Private stakeholder	Prudential Insurance		Bishnu Subedi	
Private stakeholder	Premier Insurance Co. Ltd		Shadew Tiwari	
Private stakeholder	Muktinath Bikas Bank Ltd		Govinda Bahadue Raut	
Private stakeholder	Laxmi Laghubitta		Prakash Raj Sharma	
Private stakeholder	Center for Micro Finance – NEPAL		Hari har Acharya	
Private stakeholder	Center for Micro Finance – NEPAL		Krishna Hari Baral	

Appendix 3

Development regions of Nepal

Eastern Development Region: The population of Eastern Development Region (EDR) is 5,811,555, of which 48% are males and 52% females – overall accounting for 21.9% of the total population (Anon, 2011). The adult population (18 years and older) constitutes 59%, with labour force participation at 82%. In terms of economic activities, nearly 80% of households are engaged in agriculture, which is the main sector of employment for 68.2% of the labour force. With industries numbering 570 (about 10% of total industries), the industrial sector employs about 2% of the EDR adult population (about 11% of total industry employment) especially in construction, though mostly located in the Terai region (DoI, 2014). Consequently, the hilly regions have inadequate employment opportunities, while some Terai districts have low returns on agriculture. Migration out of the region is on the rise, especially among Terai inhabitants; while urban migration has increased among hill inhabitants (UNFCO, 2011). Overall, the annual nominal household income averages NPR 122,164 and per capita income averages NPR 25,516 (Central Bureau of Statistics, 2011). The literacy rate among those 15 years old or older is relatively high: 60.8%.

Development region	Human Development Index	Gender Development Index	Gender Empowerment Measure
	New method		
EDR	0.49	0.534	0.575
CDR	0.51	0.551	0.573
WDR	0.499	0.546	0.567
MWDR	0.447	0.498	0.556
FWDR	0.435	0.481	0.523

Table 32: Performance of the different development regions of Nepal

Source: National Planning Commission, 2014.

Central Development Region: The Central Development Region (CDR) hosts the capital of the country, which is also the only metropolitan city. This region has the highest share of the total population, at 9,656,985 people. Of the CDR population, about 60% are adults. The sex ratio is 100.55, suggesting a fairly even distribution among males and females (Anon, 2011). In terms of economic activities, 64.1% of households are engaged in agriculture; this is the lowest figure for agriculture of all the development regions (Central Bureau of Statistics, 2011). Consequently, CDR has the highest number of registered industrial companies; about 75% of the total industries in Nepal are located in CDR, and they employ 6% of the CDR adult population – a staggering 71% of total industry employment (DoI, 2014). Despite the opportunities, the unemployment rate is the highest (3.2%) while labour force participation is the lowest (74.7%). By contrast, the average annual nominal household income and per capita income are the highest: NPR 152,100 and NPR 29,224, respectively (Central Bureau of Statistics, 2011). Interestingly, despite the proliferation of educational institutions in this region, adult literacy stands at just 58.6% (National Planning Commission Secretariat, 2014).

Western Development Region: Western Development Region (WDR) has a population of 4,926,765, comprising 46.5% males and 53.5% females (Anon, 2011). With the population skewed towards females, WDR has the lowest male-to-female ratio. The adult population in WDR accounts for 58% of the total WDR population, with labour force participation close to 80%. In terms of economic activities, 80% of households are engaged in agriculture, with 65.4% of the total WDR labour force directly employed in this sector (Central Bureau of Statistics, 2011). The industrial sector in WDR accounts for about 11% of total industry, numbering 640 and employing 2% of the WDR adult population: about 10% of the total industrial employment (DoI, 2014). Apart from this, WDR has the highest percentage of households receiving remittance (66.6%), although the number of migrants – 24.7% of the total population – is comparatively lower than in EDR and CDR. The annual nominal household income averages NPR 132,298, while the per capita income averages NPR 26,970 (Central Bureau of Statistics, 2011). At 64.9%, the adult literacy rate is the highest of all the development regions, and this region also has the highest rate of male and female literacy: 76.5% and 55.6%, respectively (National Planning Commission Secretariat, 2014).

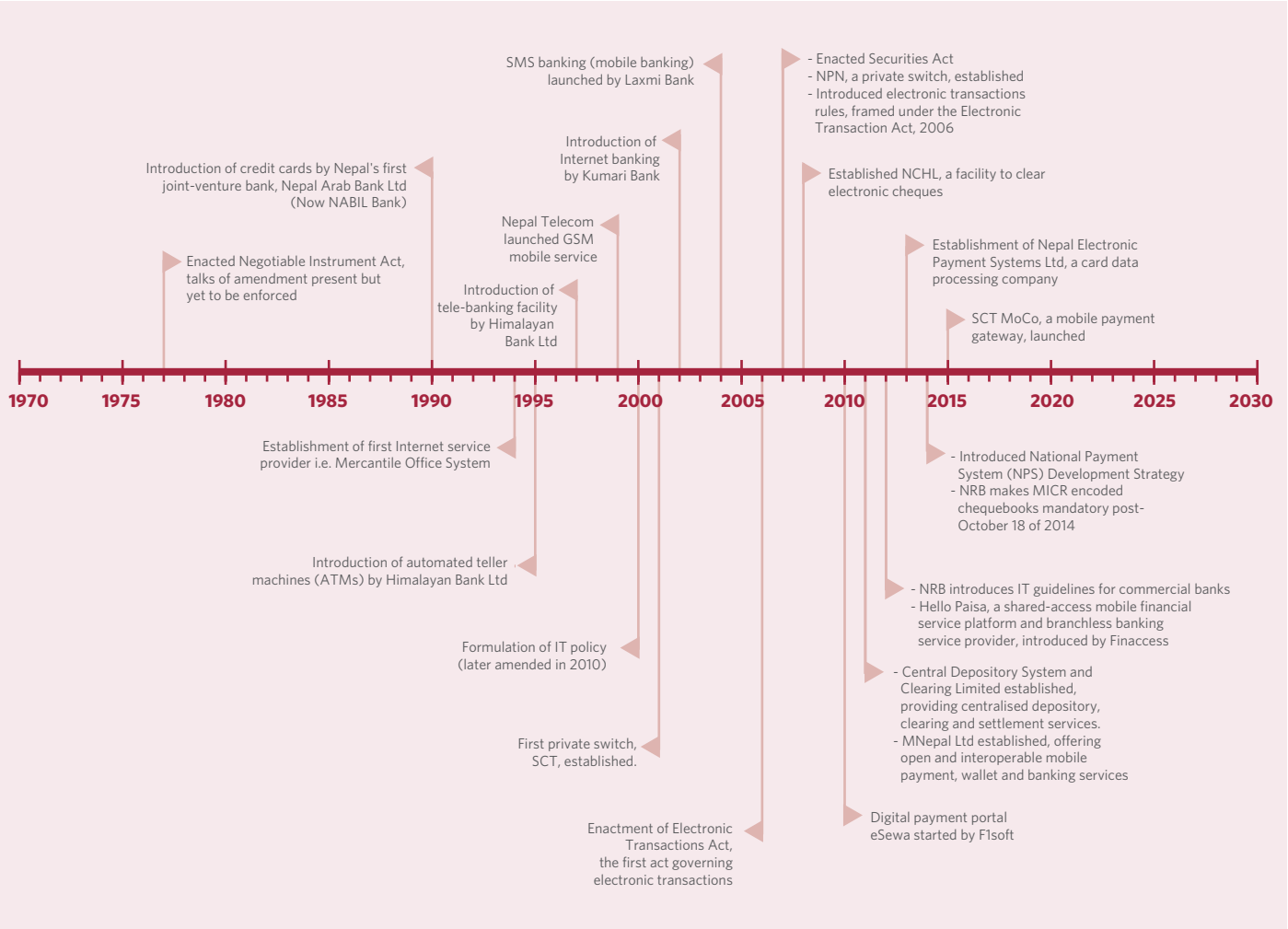
Mid-Western Development Region: Despite being the largest development region in terms of land coverage, Mid-Western Development Region (MWDR) has the lowest population density, with the population numbering 3,546,682 (Anon, 2011). This can partly be attributed to the topographical and climatic conditions of the region, with rugged terrain, dry climate and overall poor agronomic conditions (UNFCO, 2011). Despite these conditions, about 88% of households are engaged in the agriculture sector, though mostly in the Terai region (Central Bureau of Statistics, 2011). Moreover, out of 134 industries, 84% are located in the Terai, with the balance more or less evenly distributed in the hill and Himalayan regions. On the whole, the industrial sector employs less than 1% of the adult MWDR population (roughly 3% of total industry employment, of which the majority are employed in the Terai belt) (DoI, 2014). Consequently, most people in the rural areas (comprising mainly

hill and mountain regions) lack adequate access to employment opportunities, and there is a high incidence of migration to northern India in search of employment. The average household income and per capita income amount to NPR 104,544 and NPR 19,374, respectively (Central Bureau of Statistics, 2011). The literacy rate, at 55.8%, is among the lowest of all the regions (National Planning Commission Secretariat, 2014).

Far Western Development Region: Far Western Development Region (FWDR) is the smallest development region, with a population of 2,552,517: comprising 9.6% of the total population. The male population comprises about 47.7% and the female 52.3%; 53.5% of the population is adult. Of the adult population, the labour participation rate is 88.7%. Almost 90% of households are engaged in agriculture, with the latter being the main employment sector for 67.7% of the labour force. Industries in FWDR barely comprise 2% of total industries, employing about 0.5% of the adult population (DoI, 2014). As a result, migration in search of employment, especially to India, is high, with most migrants being landless, highly indebted, dalit and socially excluded groups (UNFCO, 2011). The average household income is NPR 87,524, while average per capita income is NPR 17,721 (the lowest of all the development regions). In terms of education, the literacy rate in FWDR – at 55.3% among those 15 years old and older – is the lowest among the development regions, with great disparity (the greatest of all the development regions) between males (73.4%) and females (40.2%) (National Planning Commission Secretariat, 2014).

Appendix 4

Timeline of entry of payment products, providers and regulations



Appendix 5

Insurance Performance Analysis

Performance of the insurance business in the country has been satisfactory over the years. Some indicators of industry performance are explored further here.

Contribution to GDP

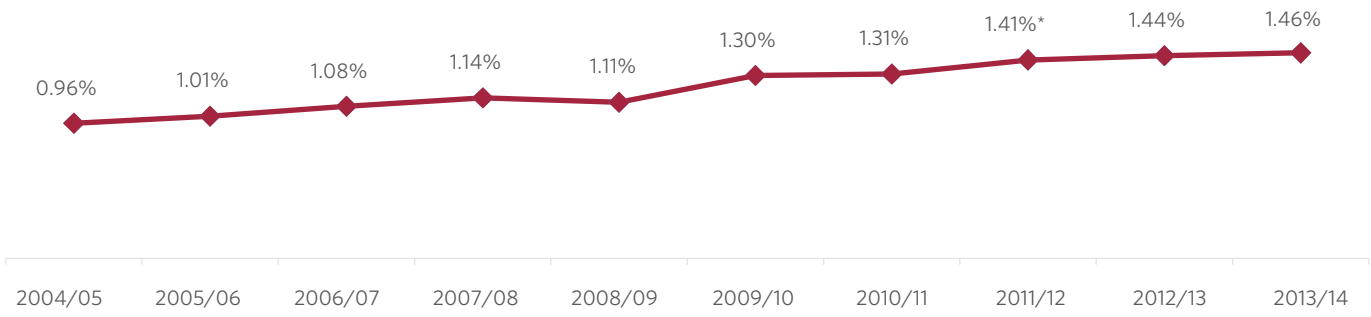


Figure 84: Contribution of the insurance sector to GDP

**Projected*

Source: Insurance Board, author calculation.

Contribution of the insurance sector to Nepal's GDP increased from 0.96% in 2004/05 to 1.46% in 2013/14. With the expansion of the insurance industry in urban and rural areas alike, the sector's contribution to GDP is gradually increasing. Nepal's insurance penetration rate is believed to be four times lower than that of China and twice as low as that of India.[1] According to Axco Insurance Information Services (London), per capita insurance spending in the country amounted to US$ 9.08 in 2012.[2]

Return on equity (RoE)

As shown in Figure 85, RoE has been increasing over time for non-life insurers, whereas it has been fluctuating for life insurers. Measured as net profits over average shareholder equity, RoE illustrates the value the insurers are providing those supplying equity investment in the company. For life insurers, one can see a lower RoE in 2009/10 and 2010/11, before improvements in performance in 2011/12 and 2012/13. This is mainly due to a fall in the net profit of the life insurers in 2009/10 and 2010/11. For non-life insurers, RoE has shown consistent growth over the same period.

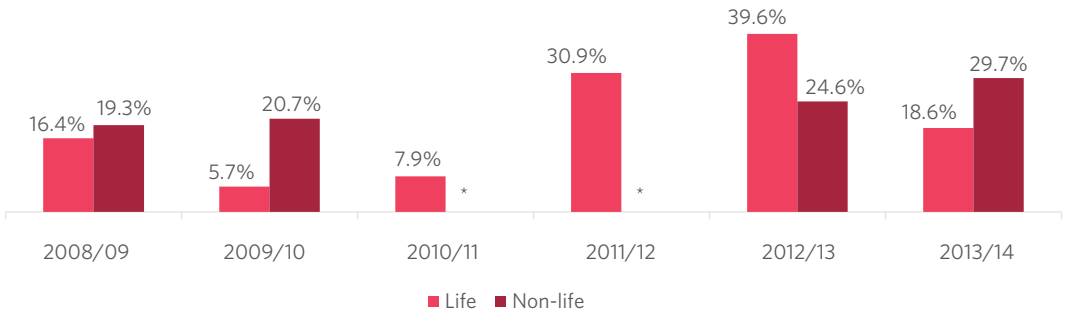


Figure 85: RoE: life and non-life insurers, respectively

**RoE for non-life segment not available for 2010/11 and 2011/12*

Source: Insurance Board, author calculations.

Net profit ratio

Net profit ratio is calculated as net profits over revenue. As shown in Figure 86, the net profit ratio for life and non-life insurers alike has fluctuated over the period 2008/09–2013/14, mainly because of the fluctuations in net profits and revenues, respectively, of the life and non-life insurance providers in the same period.

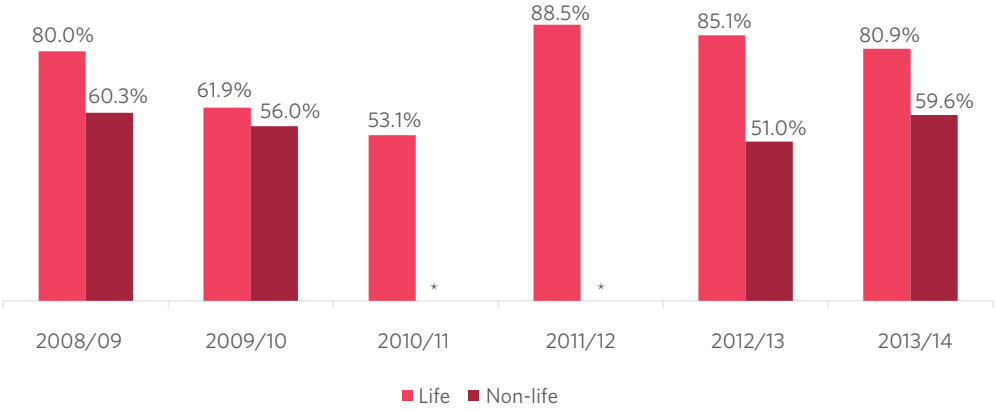


Figure 86: Net profit ratio for life and non-life insurers, respectively

**Net profit ratio for non-life segment not available for 2010/11 and 2011/12*

Source: Insurance Board, author calculations.

Net income ratio

The net income ratio measures how effectively an insurance company generates profit on each dollar of earned premium.

The net income ratio for Nepal's life insurance industry fell from 10.31% in 2012/13 to 8.7% in 2013/14. The gross premium of the life insurance industry increased by 29%, while the net profit increased by only 24%.

In the case of the non-life insurance industry, the net income ratio increased from 9.7% in 2012/13 to 12.5% in 2013/14. This can be attributed to the dramatic increase in the net profit of the non-life insurance industry – from NPR 714.6 million (2012/13) to NPR 1,307.2 million (2013/14).

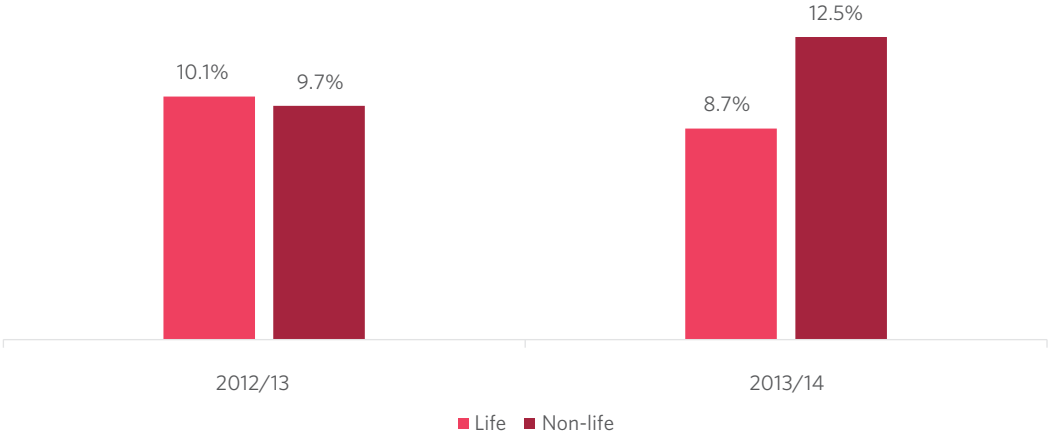


Figure 87: Net income ratio for life and non-life insurers, respectively

Source: Insurance Board, author calculations.

Loss ratio

The loss ratio measures the total claims paid as a percentage of total premiums earned. This ratio reflects if the industry is collecting premiums higher than the amount it has paid on claims, or if it has failed to collect sufficient premiums to cover the claims. Higher ratios indicate that the industry may be experiencing financial trouble because it is paying out more claims than it is receiving premiums.

The loss ratio of the life insurance industry increased from 18.2% to 34.8% between 2012/13 and 2013/14. Increase in this loss ratio for the life insurance industry can be attributed to high growth in the gross claims paid. Gross claims paid in the life insurance industry increased dramatically: by 147%, from NPR 2,514.4 million to NPR 6,201.8 million (2012/13–2013/14).

In the case of the non-life insurance industry, the loss ratio decreased marginally, from 37.7% in 2012/13 to 34.8% in 2013/14. Gross premiums increased by 28% in the period, but the claims paid increased by only 18%.

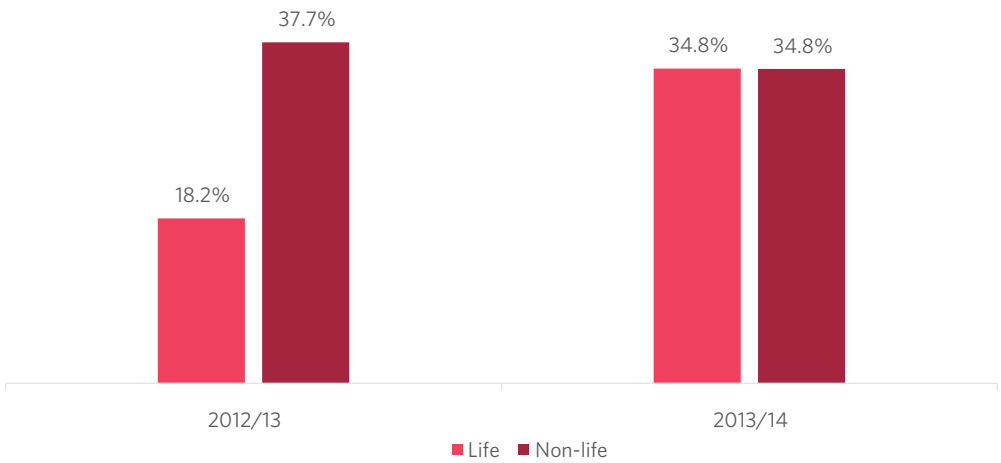


Figure 88: Loss ratio for life and non-life insurers, respectively

Source: Insurance Board, author calculations.

Claims ratio

Claims ratios indicate the percentage of earned premiums that are paid back to clients through claims. The ratios indicate the value of the product to policyholders: anything too low indicates clients are not getting great value for the premiums they pay. At the same time, claims ratios reflect the viability of the product.

In Nepal, the claims ratio of the non-life insurance industry has been hovering at around 55% of the net premiums earning (NPE) in the past three years.[3]

Notes

1 https://www.aianalysts.com/nepal-earthquake/
2 http://www.businessinsurance.com/article/20150510/NEWS06/305109979/insurance-covers-only-a-fraction-of-nepals-earthquake-damage?tags=%7C64%7C76%7C302%7C329
3 http://icranepal.com/RecentReleases/16.%20Rationale_Shikhar%20Insurnace.pdf