

**Linkages Between Commercial Banking and
Micro-Finance**



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Acronyms

ADB/M	=	Asian Development Bank Manila
ADB/N	=	Agiculture Development Bank Nepal
BOK	=	Bank of Kathmandu
BS	=	Bikram Sambat (Nepali Calender Year)
CB	=	Commercial Bank
CMF	=	Centre for Micro finance Nepal
CSD	=	Centre for Self- help Development
CSI	=	Cottage and small industry
DEPROSC	=	Development Project Service Centre
EBL	=	Everst Bank Limited
FINGO	=	Financial Intermediary Non Government Ogranisation
HBL	=	Himalayan Bank Limited
IBP	=	Intensive Banking Program
KBL	=	Kumari Bank Limited
LBL	=	Lumbini Bank Limited
LXBL	=	Laxmi Bank Limited
MBL	=	Machhapuchhre Bank Limited
MCPW	=	Micro Credit for Poor Women
MF	=	Micro Finance
MFI	=	Micro Finance Institution
NABIL	=	Nepal Arab Bank Limited
NBBL	=	Nepal Bangladesh Bank Limited
NBL	=	Nepal Bank Limited
NCCBL	=	Nepal Credit and Commerce Bank Limited
NGO	=	Non Government Ogranisation
NIBL	=	Nepal Investment Bank Limited
NICBL	=	Nepal Industrial and Commerce Bank Limited
NRB	=	Nepal Rastra Bank
PCRW	=	Production Credit for Rural Women
RBB	=	Rastriya Banijya Bank
RMDC	=	Rural Micro-Finance Development Centre
RSRF	=	Rural Self reliant Fund
SBB	=	Swabalamban Bikas Bank
SBI	=	State Bank Limited
SBL	=	Siddhartha Bank Limited
SCBI	=	Standard Charter Bank Limited
SCCO	=	Saving and Credit Cooperative
SCO	=	Saving and Credit Organisation
SFCL	=	Small Farmer Cooperative Limited
SFDP	=	Small farmers development project
WDO	=	Women Development Office

Linkages Between Commercial Banking and Micro-Finance

- Tulasi Prasad Uprety*

1. Introduction

Nepalese economy is distinctly different in its character from the regional economies. Poverty, less developed geographical situation, technological backwardness, landlocked and dominated by two large economies, etc. are the main features of the Nepalese economy. Most of the population of the country are in the rural areas, where is no enough access of banking facilities. Due to lack of awareness and lack of dependable guidance to the poor, poor are still in very severe condition at many places. From the beginning of the 1970s some programs were introduced focused to rural and the poverty stricken areas/people but these programs didn't achieve significant result in the area of the poverty reduction. The population below the poverty line is still 38 percent and it is targeted to bring down to 32 by the end of tenth five-year plan. This achievement may be impossible without making proven linkages between overall development strategy and resource availability to micro-finance institutions.

In this concern government and the central bank are policy provider some impression of doing some thing, by implementing various activities focused on these areas. But they have achieved very few achievements. Some awareness has been created, private entrepreneurs also been encouraging for participating micro credit. Some fund from the commercial banking sector has been flowing for the effective implementation of such programs in the area of poverty reduction.

In the recent years the situation is different, the role of Nepal Rastra Bank (NRB) is changing as a central banker towards being monitoring agency rather than the provider of the development finance. So its effort being made towards the implementation of the monetary policy. Composing and directing the coherent prudential regulations, effective and goal oriented (monetary policy goal) supervision, developing the financial ethics, good governance, transparent transaction and ultimately effort is to be made to make efficient financial market

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with efficient player. The main achievement in the area of poverty alleviation and rural upliftment is embedded in the national planning process and various efforts are being made to address the issue of poverty reduction.

2. NRB (Nepal Rastra Bank) Policy on Micro-Finance

Nepal Rastra Bank was established in 2013 BS (1956). Same year, accidentally 13 credit cooperatives were also established and began to provide some form of micro-financial services to the flood victim families in Chitwan district of Nepal. This was considered as the first institutional introduction of micro-credit in Nepal. In 1969/70 NRB had been conducted the Agriculture Credit Survey, which basically focused to find out the credit need to the rural as well as in agriculture. The Survey found the huge need of credit to the rural people. NRB through its direction, has implemented various credit activities in the areas of micro-finance basically most of the programs are for the credit and consequently social awareness among them. Some activities are out lined as below:

"Small Sector" Credit program

- Introduced in 2031 BS (Mid April 1974 A.D.)
- First directed credit program
- Implemented through commercial banks.
- At least 5 percent of the total deposit must be provided in Small Sector.

"Priority Sector." Credit program

- In 2033 BS (16 July 1976) definition Priority Sector was made, credit to the agriculture, small industry and service sector come into account in priority sector, which was known as "priority Sector."
- This was the first participation of commercial bank in the areas of micro-finance.
- At least 7% of total credit should be provided.
- This rate is 12% till 2059 (2003)

- This program is phasing out from 2065 (2008) (Circular date 2059/9/8)
 - 2059/60 (2002/03) - 7%
 - 2060/61 (2003/04) - 6%
 - 2061/62 (2004/05) - 4%
 - 2062/63 (2005/06) - 2%
 - 2063/64 (2006/07) - 2%

Intensive Banking Program (IBP)

- Introduced in 2038 BS (1981)
- Developed version of small sector.
- Introduction of group guarantee credit program/without collateral
- Project base credit program

Production Credit for Rural Women (PCRW)

- Introduced in 1939 BS (1982).
- Joint effort of the government office, Women Development Office (WDO) and commercial banks.
- Gender based program.
- Group focused, group formed from women workers from WDO and send to the branch office of the commercial bank, where IBP was been lunched.

Cottage and Small Industry (CSI) Credit program

- Introduced in 2042 BS (1985)
- Supported by World Bank, targeted credit program/mostly group based.
- Through commercial bank branch was selected from NRB for this program.
- CSI was first and second phase.

Lead Bank Scheme

- Introduced in 2045 BS (1988)
- Priority sector lending branch of the commercial banks was been appointed as a lead bank.
- Lead bank had to be coordinated all priority sector-lending programs implemented throughout the district.
- Basically this program failed due to lack of co-ordination.

Deprived Sector Lending Program

- Introduced in 2049 BS (1989)
- Required lend ranging from 0.25 to 3 percent out of the total loan to the hardcore poor.
- In 1993 CBs wholesale loan to Grameen Bikas Bank and Licensed NGOs, Share participation in Grameen Bikash Bank as a part of the deprived sector.

Rural Self-reliant Fund

- Introduced in 1990
- Government donated fund of 20 million
- Wholesale loan to the NGOs, Cooperatives or financial intermediaries
- NRB added another 100 million in this fund in 2003 for providing refinance to tea finance.

Micro Credit for Poor Women (MCPW)

- Introduced in 1994
- Under the ADB financial assistance

Rural Credit Review Survey 1991/92

- Conducted during the period of 1991/92.
- Objectives of this survey were:
 1. To undertake a comprehensive rural credit review study to formulate recommendations and action plan to make the rural credit system efficient, effective and responsive to the need of the rural clientele, and
 2. To strengthen the institutional capabilities of NRB to undertake this similar review periodically, argument its analytical capabilities through training and provide data storage and retrieval facilities.

Grameen Banking System

- Introduced in BS 2048 (1992) from private sector NIRDHAN program, areas focus and women focus credit and saving program supported from awareness.
- Two Grameen Bank, Eastern and Far-Western Grameen Bikash Bank were established in the equity participation of NRB, Government and Commercial Bank.
- This program came into force as a replication of Bangladesh Grameen Banking System.

- Some NGOs like Chhimek, CSD, DEPROSC were been implementing the same program in the various areas of the country.
- Rural micro credit development center (RMDC) was established in 1998 to provide wholesale fund to the micro finance institutions.

3. Evolution of Micro-Finance

First initiatives for establishing micro-finance in Nepal date back to the 1950s, when the first credit cooperatives were established. This was the milestone for the rural financial services in Nepal. These cooperatives primarily intended to provide credit only to the agriculture sector. The next milestone was SFDP in 1975 initiated by ADB/N, which covers the entire country and aims to organize farmers into small groups to provide credit without collateral.

In 1974 NRB directed to CBs to provide at least 5 of their total deposit in priority sector. In 1981, NRB introduced the Intensive Banking Program (IBP) and directed to the commercial bank to finance at least 7 percent of the total credit to the priority sector, which was further increased to 12 percent in 1990. Now this compulsion is being phased out gradually.

In 1992, Grammen Bikash Banks were initiated by the government sector, crossing a milestone in rural micro-financing in Nepal and NGOs started Grameen banking activities in certain areas.

The evolution of the micro-finance sector in Nepal

- Credit co-operatives were established in the 1950s.
- Co-operative bank was established in 1963
- Small farmer groups were established under SFDP (1970s)
- SFDP was established under ADB/N (1975)
- Commercial banks began to follow priority sector lending directives (1975)
- The IBP program tries to involve commercial banks in micro-credit (1981)
- Gender based micro-credit - PCRW (1982)
- Gender programs refined - MCPW (1994)

- Replication of Grameen Banking model (1992)
- Co-operative Act was established to support the credit cooperatives (1992)
- Government-run MF programs - Bisheswor with the Poor, Women's Awareness program, Ganeshman peace movement, etc.

4. Existing Micro-Finance Service Provider in Nepal:

From the last two-decade Micro-finance service provider institutions were begun to establish, now there more then 10 institutions in Nepalese economy, they are as follow;

Institutions	Number (Mid July 2003)
Grameen Bikas Bank	5
SBB	1
Nirdhan UB	1
Chhimek BB	1
Deprosc BB	1
FINGOs	44
SFCLs	125
SCCOs	2350*

* Some of them may not be acting as MFIs.

5. Linkages Between Commercial Bank and Micro-Finance

Poverty segmented the economic activities within the community, area and region. Now a days most of the banking activities are concentrated in urban areas due to current insurgency problem. Commercial Banks (CBs) are reluctant to initiate the lending activities in rural areas. As the adoption of economic liberalization policy, government and the central bank refraining to force CBs to be the active lender in the rural areas. In other side there is a large amount of credit demand in this sector. Rural Credit Review Survey 1991 highlights the absence of the formal sector and rural credit need was still fulfilled by the local money lenders; like land lord, shop keeper, village professional money lender, pawn porker, friends, relatives in maximum interest charge. According to the survey 80% credit is fulfilled by the informal sector and 20% only from formal sector about 6% of the creditors are enjoying both the informal and formal sector. There should be certain linkages between commercial bank and micro-finance. Certain delivery mechanism has to be developed, certain development oriented

institution and supportive institutions need to be established. Viewing this, most of the NRB's activities are in favour to this line. Now NRB is directing the phasing out of the priority sector lending program from 2065 (2000), it does not mean that NRB is not supportive to this sector but the only changes style role are changes.

- Most of the resources are in the hand of CBs and people expect that some portion of it should be provided to micro-finance sector.
- CB's are closing rural branches. Therefore to provide resources to rural poor some form of linkage needs to be set-up.
- CB's are not willing to deal in small amount so that there is a gap, which needs to be fulfilled.
- RMDC has been established from the commercial bank as equity owner and long-term loan by ADB, Manila for onlending purpose.
- At least 3% of the total credit of the CB's should be provided in the deprived sector, directly or through NGOs, Grameen Bank saving and credit model, Grameen Bank which link to the bank and micro sector.
- Today's micro sector may grow as larger activity so that CB's should think the micro sector would be the in future market.
- "Fund from urban and credit to the rural poor" would be the motto of CBs if they foresee the future market.
- CBs may provide wholesale fund to the micro finance institutions and MFIs to the poor, directly or indirectly, as equity or as lending.

Access to financial services permits individuals and households to better manage the risks and uncertainties they face to save in secure ways, to invest in a business or home, or to cope with or insure against unexpected shocks.

It has been estimated than more than 17.6 million people in Nepal need access to financial services. However, formal financial intermediaries such as commercial banks often do not serve poor households for reasons that include the lack of traditional collateral, high costs of small transactions, and geographic isolation. Poor households' access to financial services is generally limited to informal

sector loans, received either individually or through saving groups, savings and credit institutions etc.

Following the successes of some limited micro-enterprise credit programs supported by governments and donors from the 1980s, a more specialized micro-finance sector is gradually emerging. The institutions that provide micro-finance and credit services are diverse, including non-governmental organizations (NGOs), non-bank financial intermediaries, and commercial banks. The loans and credit extended are typically small (“micro”). They are provided in varying contexts, either to individuals or groups, ranging from personal micro-credit, to small enterprise support and rural finance.

Among the continuing challenges faced by developing societies and the international community is to find ways to build the capacity of the micro finance sector to complement the existing informal and private institutions, promote access to those markets for the poor, and help ensure that they are sustainable.

In the past decade, micro-finance has been recognized as a particularly effective development intervention for three basic reasons:

1. The services provided can be targeted specifically at the poor and poorest of the poor.
2. These services can make a significant contribution to the socio-economic status of the targeted community.
3. The institutions that deliver these services can develop, within a few years, into sustainable organizations with steadily growing outreach.

In this context, it is important to make a couple of distinctions:

1. Micro-finance is more than the provision of credit. It involves the provision of other financial services (most usually savings and insurance and recognizing that even the poor have a variety of needs, not just credit).
2. Securing sustainable access to micro-finances for low-income communities involves building (or reforming) micro-finance institutions- not just the

delivery of time-bound micro-finance programs (such as offering short-term revolving funds)

6. The Regulatory Status of MFIs

In Nepal Micro-finance institutions are regulated by various laws. These laws are Nepal Rastra Bank Act (2002), Banking and Financial Institution Act 2060 (Previously there are Agriculture Development Act 1967, Cooperative Act 1972, Finance Company Act 1985, Development bank act 1996, Social Welfare Act 1991, Company Act (1947), Financial Intermediary Act 1998 and Insurance Act etc. It appears to be over regulated but in reality the situation is just the opposite. There is some difficulty to regulate all micro-finance institutions because there are many MFIs established under different acts doing micro-finance activities. The ultimate responsibility to develop, regulate, monitor and supervise lies upon NRB to some extent due to fact that there is need to have good players and sound practices. It may discharge the duty through delegated methods instead on its own. Other agencies such as department of co-operatives also have serious responsibility of regulating and supervising SCCOs.

7. Challenges in Micro-Finance

Nepal has a varied topography at varied development stages, a mix of different cultures and different ethnic groups, which challenges the successful delivery of micro-finance. The major challenges are:

1. Formulating a micro-credit delivery mechanism that is better suited to the people in hills and mountains.
2. Successfully extending the outreach to the hills and mountains.
3. Redesigning existing programs of the formal MFIs to better target the poorest.
4. Unsustainable delivery mechanisms of government initiated MFIs and programs.

**Loan disbursed by RSRF is as bellow as per the date of mid October 2003
(Ashwin end 2060)**

(Rs. in thousands)

Approved Amount	Disbursed Amount	Amount Recovered	Outstanding Balance
20408	18357	15998	2359

RMDC

Under the financial support of ADB, Manila, NRB, banks and financial institutions together injected equity to through the micro-finance apex institution Rural Micro-Finance Development Centre' (RMDC), incorporated in 1998 mainly to extend wholesale fund to the micro-finance institutions. Its mandate includes capacity building for MFIs and ultimate borrowers in addition to providing a fund for on lending to them.

Provided Wholesale Loans by RMDC up to Paush end 2060 (January 14, 2004)

(Rs. in thousand)

S. No.	Partner Name	Approved Amount (Rs.)	Rate of Interest	Disbursed Amount (Rs.)	Amount Recovered (Rs.)	Outstanding Balance (Rs.)
1.	Grameen Bikash Bank	80000	1.0-6.5%	80,000	53,000	27,000
2.	Development Bank	160100	1.0-6.5%	124500	60981	63519
3.	NGOs	104060	1.0-6.15%	87560	42394	45166
4.	SCO's	24465	6.0-6.5%	7800	2970	4830
5.	Total	368625		299860	159345	140515

Small Farmers Development Bank (SFDB):

It was established under the development act and it look after the small farmer cooperatives developed by the ADB/N. Loan disbursed by the SFDB as a wholesale basis as bellow up to mid January 2004 (Paush end 2060)

S. No.	Branch	Approved Amount (Rs.)	Rate of Interest	Disbursed Amount (Rs.)	Amount Recovered (Rs.)	Outstanding Balance (Rs.)
1.	Birtamod	-	-	35213	-	-
2.	Itahari	-	-	15362	-	-
3.	Mahendranagar	-	-	12676	-	-
4.	Ratnanagar	-	-	46675	-	-
5.	Butwal	-	-	91257	-	-
	Banks	-	-	201183	-	-

Banks

As the date of mid July 2003. Total loan disbursed in priority and deprived sector by the commercial banks as bellow.

(Rs. in million)

S.No	Name of the Bank	Deprived sector		Priority sector loan	Total
		Equity	Loan		
1.	BOK	9.4	194.6	315	519
2.	EBL	3.7	127.3	420	551
3.	HBL	13.0	264	709	986
4.	NABIL	19.8	266.2	610	896
5.	NBBL	8.00	273	702	983
6.	SBI	5.2	166.8	625	797
7.	SCBI	11.00	206	505	722
8.	NIBL	14.0	134	346	494
9.	NBL	26.7	566.3	10876	11469
10.	RBB	15.0	1105	2688	3808
11.	NCCBL	5.2	70.8	323	399
12.	NICBL	0.8	68.2	284	317
13.	LBL	0.8	50.2	210	261
14.	MBL	-	7.0	141	148
15.	KBL	-	62.0	119	181
16.	LXBL	-	2	72	74
17.	SBL	-	-	-	-
	Total	132.6	3563.4	18909	22605

10. Conclusion

Nepal is the poorest country in the world and South Asia region. Its poverty reduction rate is low. The main reasons for low poverty reduction rate are: (i) low per capital income, (ii) concentrated urban growth, (iii) high population growth rate and (iv) hard geographical situation (v) and low level of education. About 38% populations are in below the poverty line. Most of the poor people are living in rural areas and have little opportunity to make self-reliant by them self. Micro-finance could help poor people who have no collateral, but a willingness to work and a desire to do some business activities from which he/she will acquire employment as well as income. Although many programs have been implemented for poverty alleviation in Nepal, only micro-finance programs are seen as a poor targeted and rural based. They are: SFDP, now SFCLs, which are managed by farmers themselves, Priority Sector Lending Program (PSLP), IBP, MCPW, RSRF and Grameen bank have been implemented.

Although Nepal has adapted market-based economy, it still needs to enhance and develop rural sustained micro financial system with the coordination of government and private sector. Today's micro finance could turn into the future market for the bank and financial institutions. Situation with appropriate market development intermediary might change in near future, if the time bound poverty addressed specialized micro financial policy environment is formulated and strictly implemented the provision of the policy towards the upliftment of the poor, and rural areas. To this end Nepal may also need to a “ **National Policy on Micro- finance**”

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