

# **Impact of Deprived Sector Credit Policy on Micro Financing**

## **Presented by Nepal Rastra Bank**

### **Introduction:**

The deprived sector credit policy is directed credit policy of Nepal Rastra Bank, which is designed to meet micro credit demand of poorer and weaker section of the country. This policy was introduced for commercial banks in 1990. Under this policy provision, commercial banks are liable to lend up to 3 percent of their total loan outstanding to deprived people. Since the inception various policy reforms are carried out to enhance the effectiveness of the policy and programs. Later, the policy was extended to development banks and finance companies also. The deprived sector includes the low income people especially socially deprived women, endogenous, lower caste, blind & hearing impaired, disabled, craftsman, artisan, small & marginal farmer and landless people. From the very beginning, these people are excluded from the formal banking services. Basically, the lending to those people who are deprived of lending from formal financial sector is comes under deprived sector credit. The main objective of deprived sector credit is to uplift the socio economic status of these people.

Micro finance is a process of delivering financial services to the deprived groups of people that includes various activities including that of micro credit, saving mobilization, transfer of money, micro insurance and payment services to rural poor people. It helps to provide self-employment opportunities and income generating activities in rural areas. It is globally accepted that micro finance is considered as a powerful tool for poverty reduction. Practically, any small amount that goes to the poor people as a credit is known as a micro credit, which is primarily provided to cater the income generating activities. Once such credit is extended it helps to increase economic activities.

The various deprived sector credit policy related activities show that it has generated a positive impact on micro financing.

### **Rationale of Deprived Sector Credit:**

Nepal is one of the poorest countries in the world. As estimated in 2004, about 31 percent people (35 percent rural and 10 percent urban) are living below the poverty line. It was 42 percent in 1996. It is understood that lack of access to productive resources is the root cause of poverty. Banks and financial institutions are main sources of financial resources. These institutions act as financial intermediaries and mobilize the financial resources in the economy. The access to financial resources activated indigenous skill and increased the productivity of the poor people. Despite the various measures, most of the banks and financial institutions are concentrated in urban and semi urban areas dealing with big borrowers and rural & poor people are forced to depend on the informal financial market. More than 85 percent people of this country live and work in rural areas. Thus rural people have not been benefited on equal footing from the recent financial development.

We cannot ignore our reality where greater role of social responsibility of commercial banks is expected. To address these problems, NRB introduced the directed credit policy. The introduction of deprived sector credit policy envisaged to help to flourish the micro financing activities in the country.

It is believed that micro credit is a powerful tool of poverty alleviation through increasing economic activities thereby increase in income, employment and livelihood. However,

ongoing micro credit programs could cover only 35 percent of total rural credit demand. Therefore, deprived sector credit policy could be instrumental to support the overall micro credit demand of rural poor.

It is estimated that 2.4 million households require the micro finance services in Nepal. The available data revealed that only 35 percent of total micro finance clients have been enrolled in the ongoing programs and large mass is still deprived from formal credit. The latest available rural credit survey revealed that very few households could have access to formal financial services.

	Rural credit survey 1991/92	NLSS 1995/96
Percent of borrowing household	38.89	61.82
From formal sources	20.30	16.28
From informal sources	82.46	83.43

Source: Rural credit survey 1991/92 and National Living Standard Survey 1995/96.

According to Monograph of Agriculture Census 2001/02, only 23.8 percent people are enjoying credit access. Out of that only 9.5 percent are provided through formal sector and remaining 14.3 percent shall depend on informal sector.

Indicator of Adequacy of Micro Finance, 2006

S.No.	Country	Micro credit outreach		
		Poor family (in million)	Micro finance client (in million)	Percent
1.	Nepal	1.6	0.5	31.25
2.	India	60.0	15.0	25.0
3.	Bangladesh	13.0	16.0	123.07
4.	Pakistan	8.5	0.58	6.82

Source: World Bank, 2006.

#### **Mandatory Policy Provision:**

In 1990, NRB issued directives to commercial banks for certain percent of compulsory lending to deprived people. The banks and financial institutions are penalized for any shortfall in prescribed amount. Since the beginning to F.Y.2053/54, government had provided interest subsidy on such credit. It has also helped to expand micro credit in that period. Followings are the policy provisions:

	1990	2008	2009
Commercial banks	0.25 to 3.00 percent	3.00 percent	3.00 percent
Development banks	n/a	1.5 percent	2.0 percent
Finance Companies	n/a	1.0 percent	1.5 percent

Source: NRB Directives.

Deprived sector credit was introduced to development banks and finance companies only in 2008.

#### **Loan Products:**

The credit goes for self employment oriented micro business or enterprises to uplift the socio-economic status of deprived people are termed as deprived sector credit. Basically, these loans are provided to income generating activities. Following credits are counted as deprived sector credit:

1. Lending without collateral up to Rs.60,000/- to group member or individual for income generating activities.
2. Lending on foreign employment up to Rs. 1,50,000/- per person.
3. Lending up to Rs. 4,00,000/- for low cost housing
4. Lending up to Rs. 1,50,000/- for micro enterprises This is basically group grantee or collateral based loan.
5. Loan up to Rs. 60,000/- per person to Micro Hydropower or household energy generating project.
6. Lending to the community hospital. up to 5 percent of respective banks' core capital
7. Youth & Small Entrepreneur Project Loan up to Rs.2 lakhs.
8. Wholesale lending to micro finance institutions, financial intermediaries, rural cooperatives, small farmer cooperatives.
9. Lending up to Rs. 1,50,000/- for various agriculture & livestock related business.
10. Equity investment on micro finance development banks and subsidiary company (Micro Finance).
11. Investment on Youth Self-Employment Fund (GON).

### Flow of Deprived Sector Credit

The flow of loans on deprived sector credit is continuously increasing. The latest data shows that, Commercial banks have provided more than 50 percent loan to Micro Credit Development Banks total of deprived sector credit. They are also involved in equity participation on most of micro credit development banks.

Rs. in crore

	2007	2008	2009	Percent
Commercial banks	721.33 (3.11)	967.04(3.15)	1341.85	4.03
Development banks	n/a	n/a	72.52	2.26
Finance Companies	n/a	n/a	65.98	1.26
Total	721.33	967.04	1480.35	

Source: Banking and Financial Statistics, NRB..

### Composition of Deprived Sector Loan (2009 July)

Rs. in corer

	Commercial banks	Development banks	Finance Companies	TOTAL	Percent
Direct	347.44	58.36	64.00	469.80	31.74
Equity	47.04	0.45	0.29	47.78	3.23
Loan to D Class	732.96	13.29	1.12	747.37	50.49
Cooperative/NGOs	91.82	-	-	91.82	6.20
Youth self-	106.42	0.26	0.57	107.25	7.24

employment fund					
Foreign employment	0.63	0.16	-	0.79	0.05
Other	15.53	-	-	15.53	1.05
<b>Total</b>	<b>1341.85</b>	<b>72.52</b>	<b>65.98</b>	<b>1480.35</b>	<b>100.0</b>

Source: NRB, Micro Finance Department.

Deprived sector credit program has the provision of direct and indirect financing. The credit provided to the beneficiaries as retail lending is regarded as direct lending whereas the lending or investment to micro finance institutions are considered as indirect lending.

### Micro finance & Deprived Sector Lending: Similarities and Differences:

Deprived sector lending is the mandatory credit policy of NRB. The main objective of this policy is to increase access to finance through ensuring adequate fund for micro financing. Under this policy regime, Bank, Development Bank and Finance Companies have to provide loan to deprived people either directly or indirectly. The policy basically focuses on credit supply. Micro finance is a package of financial services designed for poor people. These services are provided by MFIS. The main objective of micro finance is to cater the micro credit demand of rural poor.

### Regulatory Framework for Micro Finance Development banks:

NRB is responsible for licensing, regulating and supervision of Banks and financial institutions along with financial intermediaries. The main objective of regulation on micro finance is to ensure the sustainability of micro finance institutions in order to maintain continuous micro finance services to rural poor. To ensure regular financial services to the poor with easy and affordable cost NRB introduced Deprived Sector Credit for banks and financial institutions. NRB has made the provision of deprived sector credit directives under unified directives.

Financial instability hurt the poor most. To lessen this, NRB has been making effort to assure viability, sustainability and profitability of micro finance institutions through ensuring sufficient fund for micro financing.

### Impact of Deprived Sector Credit Policy:

The fundamental micro finance activities undertaken in the country revealed that the deprived sector credit policy has created favorable impact on increasing access to finance, expansion of micro finance activities and improving socio economic status of the deprived people. The impact of the policy can be evaluated based on following indicators:

## 1. Increased in access to finance:

The rapidly expanding banks and financial institutions particularly micro credit development banks have contributed to increase in access to finance of the rural poor.

### (a) Increase in number of borrowers

As of mid July 2009, there are 5.47 lakhs group members and 4.36 lakhs borrowers are enrolled in Micro Credit Development Banks. Commercial banks and other financial institutions are also providing deprived sector credit to the poor directly or indirectly through cooperatives and NGOs. Consequently, it is estimated that nearly 4 lakhs poor people are enjoying micro credit facilities.

### (b) Institutional development:

The policy has been playing very positive role in the establishment of MFIs. The number of MFIs with private sector's participation is expanding significantly. More micro credit banks and subsidiary companies are in the process of getting licenses. The following tables show the growth of banks and financial institutions and its networks.

Banks and Financial Institutions licensed by NRB

	2007	2008	2009
Commercial banks	20	25	26
Development banks	38	58	63
Finance Companies	74	78	77
Micro credit development bank	12	12	15
NGOs	47	46	45
Cooperatives	17	16	16

Source: Banking and Financial Statistics, NRB

The Number of Bank Branches (2009)

S.No.	Institutions	2008 July	2009 July	Change in percent
1	Commercial banks	555	752	35.50
2	Development banks	117	250	113.67
3	Finance companies	132	165	25.00
4	Micro credit development banks	349	367	5.73

Source: Banking and Financial Statistics, NRB

### (c) Competitive Micro Credit Business

The policy provision has assured fund for lending to the micro finance institutions. As a result numbers of MFIs have been established. It creates the competitive environment in the micro financing. The growing competition compelled to these

institutions more efficient. Consequently, the rural poor people will be benefited ultimately.

## 2. Increase in Micro Finance Activities:

### (a) Sources of Fund for MFIs

The mandatory deprived sector lending policy is being one of the main and continuous sources of funds for MFIs. The following table shows the sources and uses of fund of Micro Credit Development Banks.

### Sources of Funds of Micro Credit Development Banks:

Rs. in crore

		2007		2008		2009	
		Amount	%	Amount	%	Amount	%
Paid up capital		111.85	11.36	125.79	10.95	145.02	11.71
Deposits		137.42	13.96	142.51	12.41	203.06	16.39
Borrowing	Total	734.17	74.57	880.23	76.64	890.43	71.90
	Banks	389.26	39.54	382.17	33.27	614.15	49.59
	Other F.Inst.	199.93	20.31	337.06	29.35	95.37	7.70
	Others	144.98	14.73	161.00	14.02	180.91	14.60
<b>Sources of fund</b>		<b>984.44</b>		<b>1148.52</b>		<b>1238.51</b>	

Source: NRB, Micro Finance Department.

Out of the total sources of fund more than 70 percent share is contributed by borrowing. The total structure of sources of fund, paid up capital and borrowing, shows that Banks and Financial Institutions are the major contributor.

### Contribution on Paid Capital

S.No.	Particulars	Amount
1.	Total paid up capital (Rs. in crore)	145.02
2.	Share of Banks and Financial Institutions (Rs. in crore)	47.78
3.	Percent	32.95

Source: NRB, Micro Finance Department.

### Contribution on Borrowing

Rs. in corer

S.No.	Particulars	Amount	Percent
1.	Total borrowing	890.43	100.00
2.	Banks	614.15	68.97
3.	Financial Institutions	95.37	10.71

4.	Others	180.91	20.32
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Source: NRB, Micro Finance Department.

### **Borrowing /Lending Ratio**

Rs. in corer

	Total lending (Outstanding)	Total Borrowing	Percent
2007	578.06	734.17	127.00
2008	707.82	880.23	124.35
2009	823.13	890.43	108.17

Source: NRB, Micro Finance Department.

#### (b) Lending Activities

The above tables show that the lending of banks and financial institutions and MFIs are increasing significantly. As of mid July 2009, the total loan disbursement of micro credit development reached to Rs. 41.60 billion and at the same time Rs. 35.61 billion is being made repayment.

#### (c) Saving:

As of mid July 2009, the total saving of poor people only in Micro Credit Development reached to Rs.1.76 billion.

The above tables indicate that the provision of deprived sector credit policy has contributed significantly on the various aspects of Micro Credit Development Banks and micro financing activities in the country.

### 3. Improvement in Socio-economic Status

Micro credit program helps to assemble poor people in-group, give an opportunity to discuss and share of information about their business and create awareness against poverty. Micro credit financing procedure has developed the attitude of financial discipline among the poor. As a result the flow of micro credit, outstanding repayment rate and increase in group savings has been achieved by MFIS. This indicates that the policy provision has enhanced the socio economic status of the deprived people.

### 4. Increase in Economic Activities

Once the poor people get credit for income generating activities it energized them and became more productive. It will help to enhance economic activities thereby increase in income, self-employment and livelihood of the poor people.

### **Challenges:**

1. Accessible rural finance on a sustainable manner is a more challenging job. Number of micro finance institutions is engaged in micro finance business. This will certainly increase the competition among these institutions. Growing

competition and distinct feature of geographical setting and political uncertainty that poses the great risk to viability, sustainability and profitability.

2. Deprived sector credit policy has assisted in fulfilling the required sources of fund for micro finance institutions. The recent regulatory reform on opening of subsidiary company and variety categories of lending included in deprived sector lending might create great threat of low possibility of getting wholesale fund from banks and financial institution.
3. Gradually increasing wholesale interest rate and operational cost of micro financial institutions forced to increase in retail loan. However, poor people still have to face high interest rate. Current political scenario also does not support to raise the interest rate. Ultimately, it will adversely affect on profitability of micro finance institutions.
4. Micro finance services are crowded in easily accessible areas and it creates the problem of duplication. However in hill and mountain no one is interested to provide services in those areas.
5. Monitoring and supervisory business of these micro finance institutions is considered very costly. Being distinct nature of working procedure of these institutions separate regulatory and supervisory body should be formed. It will enhance the effectiveness both of regulation and supervision.
6. Banks & financial institutions have not adequate network to rural areas and expertise dealing with micro finance direct to the rural poor.
7. Low recovery rate on priorities sector or deprived sector credit of commercial banks and recently loan waiver program of government will further hamper lending in rural finance.

### **Recommendation:**

1. The on going revision on reformation of deprived sector lending could create the problem of borrowing to MCDB. To solve the problem it should be allowed to micro credit development bank for deposit collection with some regulatory conditions.
2. It is appropriate to review corporate tax on MCDB as par with cooperatives.
3. Banks and financial institutions are very encouraging to establish separate micro finance subsidiary company. NRB should be watchful in dealing with inter bank transaction just to meet deprived sector lending target and fund parking in different way.
4. To ensure the continuous flow of financial resource, a national level micro credit development fund should be maintained. It will build confidence among the micro finance institutions for lending to poor.
5. To increase micro credit access to hill and remote areas, government also has to involve in infrastructure development activities. It will help to develop market center.

6. Maintaining overall macro economic stability together with financial stability to ease the socio-economic condition of poor people is a must.

## **Conclusion**

The introduction of deprived sector lending policy has been playing very important role in the expansion of micro financing. It is globally accepted that micro finance services help to enhance access to finance to rural people. Access to finance is being considered as an imperative aspect of poverty alleviation efforts. Banks, development banks and finance companies are main source of financial resources of the country. Due to the various reasons, these institutions are voluntarily unwilling to involved in small and rural financing. In order to provide certain portion of their resources in the rural financing NRB had introduced the directed credit policy. Since the MFIs are not deposit taking institutions, their activities are depended on the availability of fund from other financial institutions. The policy provision has ensured the continuous flow of fund for MFIs that help to expand their activities smoothly. However, most of the micro finance services are concentrated in terai, urban, and easily accessible region whereas the people from remote, hilly and backward regions are still deprived from the formal financial services. To increase the financial access to vast majority of poor people the deprive sector credit policy is still relevant for further expansion of micro finance activities in the country.