

**Supply/Availability of Wholesale Funds for MFIs in Nepal:  
Challenges and Problems**

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# **Supply/Availability of Wholesale Funds for MFIs in Nepal: Challenges and Problems**

## **Abstract**

This paper intends to explore different aspects of supply of wholesale funds and the threat of drying up the resources and probably the sustainable solution: saving mobilization from the general public. Study finds Nepalese microfinance institutions are getting wholesale funding from commercial sources under deprived sector lending scheme and from specialized wholesale institutions. The deprived sector lending provision has played a very big role to promote and develop microfinance industry. Since the scope of deprived sector is being made broader, available funding under deprived sector lending scheme is diverted to Youth Self Employment programme, funding for growing Nepalese microfinance sector is getting drier slowly. MFIs are in rush to catch the scarce resources and the cost of fund is increasing. In this context, public deposit could be the last resort to microfinance institutions, however, deposit mobilization is not so easy task. Besides mobilizing deposit from the public deprived sector lending scheme is needed for MFIs for many years to come. NRB needs to permit MFIs setting stringent criteria and limits to mobilize deposits from the public.

## **1.0 Background**

Microfinance is often defined as financial services for poor and low income clients. It is a package of financial services for individuals, families or entrepreneurs excluded from traditional or commercial financial system. It is the broad range of financial services such as loans, deposits, payment services, money transfer and micro insurance to poor and low income households and their microenterprises.

More broadly, microfinance refers to a movement that envisions a world in which poor and low income households have permanent access to a range of high quality financial services to finance their income- generating activities, stabilize consumption, and protect against risks. These services are not limited to credit, but include savings, insurance and remittances.

In Nepal, micro finance institutions (MFIs) are working as regulated micro finance development banks (MFDBS),not-for-profit organizations as financial intermediary non-governmental organizations (FINGOs), Savings and Credit Cooperatives (SACCOS), and self-help groups. The microfinance business is becoming a for-profit business with strong social motives. The institutional sustainability and professionalism are getting importance in microfinance field nowadays. Since the microfinance institutions mobilize savings only from the members, they lack sufficient funding for on-lending. The common sources of financing are the equity, savings, borrowings and grants.

### **1.1 Objectives**

The broad objective of the paper is to explore different aspects of wholesale funding and challenges due to the drying up resources and recommend the probable solution. To achieve this goal following specific objectives were analyzed:

- An overview on current pattern of financing mix,
- Analysis of supply and use of current funding,
- Analysis of growth trend and demand forecasting
- Analysis of expected supply and the gap
- Analysis of probable sources to meet the gap.

### **1.2 Methodology**

This paper is prepared based on analysis of secondary data from various sources. Various literature were studied . Among them the major are the annual reports of Nepal Rastra Bank (NRB), Rural Microfinance Development Centre (RMDC), Sana Kisan Bikas Bank Ltd. (SKBBL) and many Microfinance Development Banks (MFDBs). Besides annual reports and other publications of MFDBs, FINGOS, SACCOS were studied. Legal documents like Bank and

Financial Institution Act, 2006, various circular and directives, policies of NRB were studied. The websites of NRB, RMDC, SKBBL, MIFAN, GON/DOC were visited to get needed information. Growth trend was analyzed to forecast the demand. The supply side was analyzed by reviewing the available funds under deprived sector lending scheme as well as wholesale lending scheme.

## **2.0 Review of Literature**

As per NRB's licensing policy the microfinance development banks which fall under Class "D" financial institution as per Bank and Financial Institution Act, 2006 needs to have at least Rs. 10 million as paid-up capital to operate in 3 districts, Rs. 20 million to operate in 10 districts, Rs 60 million to operate in a region and Rs. 100 million to operate at national level. Out of their paid up capital at least 30 percent should be sold to general public. FINGOS and SACCOS are allowed to work in one district at the beginning and later their working districts are added after complying the directives from NRB. They must maintain positive net worth.

In Nepal, MFIs are allowed to mobilize savings only from their members/ clients. They cannot accept deposit from the general public. Most MFDBs are adopting mandatory and voluntary saving schemes. Under mandatory savings the clients need to deposit certain amount in their regular meetings and certain percentage of loan amount (ranging 3 to 5 percent) is also deducted and deposited in the same account. Under voluntary savings, the clients can deposit any amount they can. Some MFIs are mobilizing savings in the form of contractual savings like pension savings Chimmek Bikas Bank Ltd. and others. Generally, the saving balances finance about one-third of their loan portfolio.

As per article 47 sub-article (7) (j) of Bank and Financial Institution Act, 2006 the class "D" microfinance development banks can collect and pay back savings with interest or without interest subject to limit prescribed by Nepal Ratra Bank (NRB).

The main source of wholesale funding is the commercial banks. They provide wholesale funding to MFIs under deprived sector lending scheme. As per NRB directives, deprived sector lending is the directed mandatory lending under which commercial banks (class "A" financial institutions) need to lend at least 3 percent of their portfolio to deprived sector, the same is 1.5 percent for class "B" development banks and 1.5 percent for class "C" finance companies. To lend under deprived sector, a financial institution can disburse small loans directly. NRB has given option to lend to MFIs or invest in the equity of such MFIs.

### 3.0 Data Presentation and Analysis

#### 3.1 Savings to Loan ratio

MFIs are characterized with low capital base, little saving mobilization-about one-third of loan portfolio, and small or no grants.

Table 1

The loan portfolio and savings of few MFIs as of 31 Ashad, 2066 (15 July, 2009)

(Amount in Rs.'000)

S. No.	Name of MFIs	Gross Loan Portfolio	Savings	Savings/loan ratio
1	Nirdhan Utthan Bank Ltd.	1,118,639	336,825	30.11%
2	Chhimek Bikas Bank Ltd.	894,178	416,398	46.56%
3	Swawlamban Bikas Bank Ltd.	699,699	327,407	46.76%
4	Paschimanchal Grameen Bikas Bank	596,639	162,175	27.18%
5	Madhyamanchal Grameen Bikas Bank	451,921	142,075	31.43%
6	Nerude Laghu Bitta Bikas Bank	309,956	102,250	32.98%
7	FORWARD (FINGO)	302,420	117,413	38.82%
8	CSD (FINGO)	290,691	158,129	54.39%
9	Jeevan Bikas Samaj, (FINGO)	315,954	122,766	38.85%
10	Muktinath Bikas Bank (Class B Dev. Bank)	75,231	21,040	27.96
11	Sahara Cooperative, Jhapa	300,743	115,529	38.41%
12	Karnali Cooperative	69,854	29,307	41.95%
13	Manushi (FINGO)	62,020	31,260	50.40%
14	UNYC, Bardiya, (FINGO)	26,498	11,776	44.44%
15	Baudha Cooperative Surkhet	15,205	10,138	66.67%
16	Sana Kisan Cooperative	81,178	57,683	71.05%

Source: Grameen Laghubitta, Vol.29, 2066 Ashad, RMDC.

The saving to loan ratio in these institutions varies from 27.18 percent to 71.05 percent, however, we can conclude that their savings are not enough to meet their on-lending funds.

#### 3.2 Sources and Uses of Funds

Financing in MFIs is matched with borrowed money which they receive from commercial banks under deprived sector lending scheme. Commercial banks, Rural Microfinance Development Centre Ltd. (RMDC), Sana Kisan Bikas Bank Ltd. (SKBBL), Nepal Rastra Bank- Rural Self-

Reliance Fund (RSRF) are the major sources of wholesale funding to MFIs in Nepal. Some MFIs have received wholesale funding from multilateral funding projects like Third Livestock Development Project (TLDP), Poverty Alleviation Project in Western Terai (PAPWT), and Community Ground Irrigation Sector Project (CGISP). Few MFIs have/had received funding from foreign institutions like Grameen Trust, Bangladesh.

Table 2  
Sources and Uses of Funds of Class D MFDBs

(Amount in Rs. '000)

S.No.	FY	Capital	Members' savings	Borrowings from Commercial Banks	Borrowing from other Financial institutions	Borrowing from others	Total Resources	Total Loans and Advances	Surplus Amount
1	2006/07	1,118,500	1,384,161	3,892,613	1,999,300	1,449,781	9,844,355	5,780,600	4,063,755
2	2007/08	1,257,900	1,425,053	3,821,713	3,370,607	1,609,953	14,485,226	7,078,200	7,407,026
3	2008/09	1,450,176	2,030,612	6,141,530	953,677	1,809,103	12,385,098	8,231,287	4,153,811

Source: NRB

From the financing mix of these MFIs, the borrowing is the most critical component of financing. It covers about 76 percentage of total resource mobilization. The members' savings comes next followed by equity. Till the FY 2008/09, MFIs are enjoying surplus resources.

### 3.3. Sources of Wholesale Funding

**3.3.1 Deprived Sector Lending from Commercial Sources:** The main source of wholesale funding is the commercial banks. They provide wholesale funding to MFIs under deprived sector lending scheme.

Table 3

Status of deprived sector lending from commercial banks, development banks and finance companies as of Ashad Last, 2066 (Mid- July 2009)

(Amount in Rs. '000)

S. No.	Types of Financial Institutions	Direct Lending to Clients	Indirect Lending						Total
			Share	Class D MFDBs	Coop. FINGOs	YSEP	Foreign Emp.	Other	
1	Commercial Banks	3,474,447	470,430	7,324,691	918,325	939,210	131,282	155,273	13,413,568
2	Development Banks	583,672	4,500	132,857	0	2,615	1,608	0	725,207
3	Finance Companies	640,008	2,925	11,226	0	5,723	0	0	659,882
	Total	4,698,082	477,855	7,468,774	918,235	947,548	132,890	155,273	14,798,657
		31.75%	3.23%	50.47%	6.20%	6.40%	0.90%	1.05%	

Source: NRB

These financial institutions have channelized their 50 percent of their deprived sector portfolio through class "D" microfinance development banks.

### 3.3.2 Specialized Wholesale Institutions

**3.3.2.1 RMDC:** Rural Microfinance Development Centre Ltd. (RMDC) is an apex wholesale – lending organization of microfinance. Besides, it also works for promotion and development of microfinance in the country. It promotes financially viable and sustainable MFIs by providing necessary financial and technical support to potential institutions. It makes due diligence before disbursing loan to particular MFI.

Table 4

Results of Financing from RMDC.

Particulars	Unit	Results		
		Mid-July '06	Mid-July '07	Mid-July '08
Disbursed	Rs. million	298.24	961.07	525.02
Repaid	Rs. million	123.22	326.88	405.64
Total Outstanding	Rs. million	500.85	1,135.04	1,254.42

Source: RMDC Annual Report 2007-08.

**3.3.2.2 SKBBL:** Sana Kisan Bikas Bank Ltd. (SKBBL) is a specialized wholesale micro-financing development bank established with the aim of promoting and strengthening grassroots level Small Farmer Cooperatives Ltd. (SFCLs) in particular and similar other microfinance intermediaries in general. The bank provide short and medium term wholesale credit or refinance to SFCLs and other similar grassroots level financial intermediaries.

Table 5

Results of Financing from SKBBL

Particulars	Unit	Results	
		Mid-July '07	Mid-July '08
Disbursed	Rs. million	697.48	912.33
Repaid	Rs. million	657.264	846.38
Total Outstanding	Rs. million	1,327.04	1,445.42

Source: SKBBL 7<sup>th</sup> Annual Report 2064/65.

**3.3.3 Rural Self-Reliance Fund (RSRF):** To increase the income and render employment opportunities for the deprived people in the rural areas, the Government of Nepal has established RSRF in 1991 with seed capital of Rs. 20 million and added another 20 million in 2004/05. NRB has provided additional money from its profit to this fund in different periods. RSRF provides

the wholesale credit for on-lending purpose to deprived people through MFIs, cooperatives, FINGOs.

Table 6  
Results of Financing from RSRF

Description	Mid- July 2007	Mid- July 2008
Loan Disbursement:		
No. of Districts	48	50
No. of MFIs	277	334
No. of Beneficiary families	12,228	14,862
Loan Disbursed (Rs. in million)	132.6	193.4
Loan Collected (Rs. in million)	81.2	102.3
Outstanding loan (Rs. in million)	51.4	91.1

Source: NRB, Annual Report 2064/65.

### 3.4 Demand Analysis

#### 3.4.1 Demand of on-lending funds to MFDBs

The microfinance clients, the loan portfolio outstanding, and savings are in increasing trend.

Table 7  
Borrowings needed for On-lending to MFDBs

(Amount in Rs. thousand)

Indicator/ Year	Actual			Projected	
	2006/07	2007/08	2008/09	2009/10	2010/11
No. of Members	409,113	501,059	561,624	658,678	772,504
No. of Loan clients	339,048	394,711	441,711	504,268	575,685
Loan Portfolio	5,780,600	7,087,200	8,231,287	9,795,232	11,656,326
Savings	1,384,161	1,425,053	2,030,612	2,396,122	2,755,540
Equity	1,118,500	1,257,900	1,450,176	1,645,950	1,859,923
External Resource Needed	3,277,939	4,404,247	4,750,499	5,753,160	7,040,863

Source: MFDBs and NRB

From the table, the loan outstanding in MFDBs is growing rapidly and it is expected to reach to Rs. 9,795,232 thousand in Mid- July 2010. The savings mobilized from the members would be

only Rs. 2396,122 thousand, equity Rs. 1,645,950 thousand indicating a gap of on-lending fund by Rs. 5,753,160 thousand at the same date.

### 3.4.2 Demand of On-lending fund to FINGOs

25 FINGOs licensed from NRB are serving 329,755 poor clients and they have total loan outstanding of Rs. 2,183,221 thousand and saving of Rs. 864,283 thousand as of Mid- July 2009.<sup>1</sup>

Table 8

Demand of On-lending fund for FINGOs<sup>2</sup>

(Amount in Rs. Thousand)

Time line	Members	Loan Outstanding	Savings	Borrowings needed
Mid- July 2009	329,755	2,183,221	864,283	1,318,938
Mid- July 2010	362,731	2,401,546	950,7132	1,450,833

Source: MIFAN

### 3.4.3 Demand of on-lending fund for Cooperatives

The demand of on-lending funds to SACCOS is also in increasing trend. As per Department of Cooperatives, there are 5,162 SACCOS with membership of 714,516 as of Chaitra end 2065 (Mid- April 2009)<sup>3</sup>.

Table 9

Demand of On-lending fund for SACCOS<sup>4</sup>

(Amount in Rs. Thousand)

Time line	No. of Members	Total Loan Amount	Available Resources		Resource Needed
			Savings	Equity	

<sup>1</sup> Source: Microfinance Association of Nepal (MIFAN).

<sup>2</sup> Since FINGOs are not for profit organization, they have little equity, therefore ignored while calculating the demand of on-lending funds.

<sup>3</sup> Source: Department of Cooperatives, GON.

<sup>4</sup> Due to lack of reliable data on cooperatives engaged microfinance business, all these 5,162 SACCOS are assumed as MFIs as their loan outstanding per member is Rs. 28.165 thousand, and the projection is made taking 10 percent growth .

Mid- Apr 2009	714,516	20,124,886	16,247,310	2,191,126	1,686,450
Mid- Jul 2010	785,968	22,137,386	17,872,050	2,410,240	1,855,096

Source: Department of Cooperatives, GON

### 3.4.4 Total demand for MFIs

MFIs need funding not only for on-lending, rather for operating expenses, capital expenditure and to keep mandatory reserves and provisions. Besides, they need to maintain funds enough to meet at least three months demand because they cannot get the money as and when needed. From the above analysis, the demand of funding for MFIs in FY 2009/10 seems to be Rs. 11,323,861 thousand besides the savings mobilized from clients and their equity.

Table 10

Demand of funding for MFIs in FY 2009/10

(Amount in Rs. Thousand)

Types of MFIs	Expected No. of Clients	Funds needed for On-lending	Funding needed for additional 3 months	Total Funds needed
MFDBs	658,678	5,753,160	1,438,290	7,191,450
FINGOs	362,731	1,450,833	362,708	1,813,541
SACCOS	785,968	1,855,096	463,774	2,318,870
TOTAL	1,807,377	9,059,089	2,264,742	11,323,861

### 3.5 Supply Analysis

On the supply side, almost all private sector commercial banks are providing wholesale lending to MFIs rather than channeling small loans to individual clients under deprived sector lending. The development banks and finance companies are also asked to direct some of their lending towards deprived sector, this has increased the supply of wholesale funding, however, their portfolio being smaller compared to commercial banks.

Table 11

Status of Loan Disbursement of Commercial Banks, Development Banks and Finance Companies and available funding under Deprived Sector Lending

4 (Amount in Rs. thousand)

S. No.	Types of Financial Institutions	Actual			Projected
		2006/07	2007/08	2008/09	2009/10
1	Commercial Banks: Total Loan	215,978,400	292,500,400	382,082,290	476,838,697
	Deprived Sector loan	7,213,325	9,670,417	12,869,333	14,305,160
2	Development Banks: Total Loan	11,930,334	21,533,633	39,425,641	57,163,236
	Deprived Sector loan			724,137	1,143,264
3	Finance Companies: Total Loan	21,085,294	36,902,652	51,165,790	69,263,129
	Deprived Sector loan				
4	Total Amount available under Deprived sector lending scheme	7,213,325	9,670,417	14,253,352	16,487,372
5	Funding towards YSEP Fund (1/3 of DSL Funding)				5,495,790
6	Amount for Direct Lending to clients (32 %)				5,275,956
7	<b>Remained Amount for MFIs</b>				<b>5,715,626</b>

Source: NRB

The total available funds under deprived sector lending is Rs. 16,487,372 thousand, out of this one-third i.e. Rs. 5,495,790 thousand goes under YSEP and rest Rs. 10,991,582 thousand will be available for direct lending from these institutions as well as lending through MFIs. As per last year's trend 32 % of the total DSL fund will be channelized by banks and financial institutions to their customers directly. Rs. 5,715,626 thousand only is remained for channeling through MFIs.

## **4.0 Findings, Conclusion and Recommendations**

### **4.1 Drying up resources and increasing cost of funds**

From the demand analysis, the expected demand for MFIs in FY 2009/10 is expected to be Rs. 10,352,454 thousand whereas the available supply under DLS scheme is 5,715,626 thousand after excluding the provisions for YSEP and directly lending from banks and finance companies. Wholesale institutions like RMDC, SKBBL and RSRF have not enough money to meet the gap. This indicates the supply of funds for MFIs is getting drier. MFIs are now in rush to catch the scarce resources, and feeling difficult to get it and paying higher rate of interest (currently 7-9%) than they have paid earlier (4-6%). The current financial crisis has further made MFIs position very hard, they have either to increase the interest to its clients or squeeze their business, both options being very painful. This will adversely affect the growth of microfinance industry. Because of scarcity of resources and increasing cost of funds, MFIs may think twice to expand their services in the remote and high hills which will further push the poor people living in remote area further back.

Besides, the provision of mandatory deprived sector lending schemes, the evolution and growth of wholesale funding agencies like RMDC, SKBBL and RSRF have made a significant contribution for the growth of microfinance industry in Nepal. This has created a big financial market among the poor households. Microfinance institutions are serving the un-served and under- served people. Despite the contribution, recent directives from NRB has widened the scope of deprived sector lending, commercial banks have option to establish subsidiary company focusing on small loans, they can lend to micro hydro projects, hospitals, low cost housing and many more, keeping the resources to MFIs drier. If this goes on continually without alternative provisions to MFIs, they will be compelled to be consolidated and they hesitate to expand the services which will jeopardize the whole effort of providing access to financial services to poor. MFIs will be compelled to reduce their lending and incur losses. They may hesitate to expand their services to under- served and un-served people and region.

## **4.2 Conclusion and Recommendation**

### **4.2.1 Deposit mobilization from the public for sustainability.**

Due to prudential regulations from NRB, many MFDBs are emerging professionally as very big institutions, they have enough capital, professional management, good governance practices. Similarly, many of them have wide branch network and well managed computer based management information system. NRB, now, needs to come up with policy to allow MFIs to mobilize deposit from the general public of course with stringent criteria for the safety of public deposit. The criteria can be set in the area of capital adequacy, core capital and saving mobilization limits, good governance, etc. However, even after allowing MFDBs to accept the public deposit, the provision of deprived sector lending remains to be the most important sources of funding for MFIs in many years to come.

At the beginning, collecting deposit from the public may cost more for MFIs than getting wholesale funding from commercial banks, but deposit is the only way that makes MFIs sustainable in the long -run. Most Nepalese microfinance institutions are moving towards achieving operating and financial self-sufficiency. They have professional management with competent human resources, and they are applying the best practices of microfinance. This has increased the clients outreach, branch network and have created a faith among rural poor people which will help them to mobilize savings from public.

Commercial banks like Rastriya Banijya Bank, Nepal Bank Ltd, Agriculture Development Bank have closed their many rural branch offices during insurgency, and they are hesitant to re-establish these branch offices in rural areas. MFIs like Nirdhan Utthan Bank Ltd. having the 4<sup>th</sup> biggest branch network in the country, can serve the missing middle for their need of financial services to deposit their saving. This enables their access to formal financial services.

#### **4.2.2 Government's Role**

Government has so far played conducive role by enacting the laws recognizing microfinance as financial business, however, it is treating MFDBs as commercial organization and charging the highest corporate tax on its profit. If the tax rate could be lowered, the amount so saved can be used to provide services to more poor people. Government could also provide support to MFIs as grant in planned manner to expand their services in remote and un-served areas of the country. However, such grant should be linked with performance.

#### **4.2.3 International Sources**

Besides, the deprived sector lending, deposit mobilization, lending from wholesale funds, MFIs should also search international sources of financing. Social investors in the developed countries are interested to provide financing to the poor people in developing countries like Nepal. The web based financing is increasing its stake in microfinance sector. KIVA has increased its wholesale funding business in many countries and it is interested to enter into Nepalese market. WEAL/GoodReturn, Energy in Common (EIC) are also interested to provide wholesale funding to Nepalese MFIs. Whether NRB should come up with little more enabling policy to invite such international funds for Nepalese MFIs. Funding from international sources is not easy because of higher rate of interest and the risks of currency devaluation.

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