CHAPTER - I

INTRODUCTION

1.1 Background of the Study

The rise of microfinance is one of the most significant phenomena in development policy in the recent years. Microfinance sector in Nepal is seen as a joint effort of government and private sectors implementing various financial programmes including saving and credit cooperative activities, number of informal credit groups promoted through different donor supported programmes, such as poverty alleviation programmes and the other activities supported by different donors and INGOs. Micro finance is regarded as an effective tool for poverty alleviation. The Asian Development Bank has recognized micro finance as a powerful tool to promote economic growth, reduce poverty, support human development and improve the status of women. For the past 20 years, the government, international agencies and social organizations have been focusing on women's development programs. And Banks of Venice, which was established in 1157AD, is regarded as the first commercial bank in the world. In Nepal, Nepal Bank Ltd was established in 1937 AD is the first commercial bank. In order to maintain uniformity of operation of all commercial banks in Nepal. The umbrella act "bank and financial Institution Act 2063" A commercial bank refers to such bank which deal in exchanging currency, accepting deposits, advancing loan and performing other commercial transaction". A commercial bank is a financial institution, which collect saving from general public and institution and provides loan and advance facilities to different industries and commercial business. Commercial bank helps to collect the idle money of general public for providing money to needy people, firms or industries to get productive use. In between these intermediaries depositors and bank gets some earning. The main function of commercial banks are accepting deposits, advancing loan or credit, investing collected funds to the profitable project, performing agents of the customer, funds transfer, foreign exchange transaction and miscellaneous transaction (Lohani, 2010).

The main priority of the tenth five years plan and thirteenth three year plan were poverty alleviation, women's empowerment and gender mainstreaming. Most of the poor people live in rural areas and have little opportunity. Micro-finance could help poor people who have no collateral, but willingness to work and desire to do some business activities from which he/she will acquire employment as well as income. Therefore, what is more the economic environment provides great business opportunities. Most Nepalese micro entrepreneurs are economically isolated, which means that their market is often local, small and does not offer any demand growth prospects. Commercial banks and other financial institutions normally do not like to go in that area because of the geographical constraints. However on the other hand, there is a substantial demand of micro credit in the rural areas. In this scenario, locally operating micro finance institutions such as SFCL could obviously play an important role to mobilize local savings, extend credit as well as channelize borrowed fund/grant to the local rural people (NPC, 2016).

Micro finance is equally important to both men and women. Women's experience of poverty is different and more acute than that of men because of gender-based forms of exclusion. Women become poor through deterioration in the household's access to resources. Women's lives are governed by more complex social constraints and responsibilities than men's and they are more concentrated in the non-monetized sector. In almost every Asian country women comprise a large percentage of the poor. The existence of the gender complexities in the handling of income affects the quality life, the quality of children's nutrition and education, as well as household stability. Unless and until women do not have access to economic opportunities, poverty cannot be reduced, as well as direct lending is a form of corporate debt provision in which lenders other than banks make loans to companies without intermediaries such as an investment bank, a broker or a private equity firm. In direct lending, the borrowers are usually smaller or mid-sized companies, also called small and medium enterprises, rather than large, listed companies, and the lenders may be wealthy individuals or asset management firms (Pokharel, 2010).

According to Cambridge Dictionary, "A situation in which a person or organization lends money directly to another person or organization without involving anyone else in the arrangements."

Nepal Rastra Bank (NRB) has introduced the concept of directed lending at 1974. Commercial banks were required to extend credit of at least 5 percent of their total deposit liabilities to the small sector comprising agriculture, cottage industry and services. The small sector program was redefined in 1976 and termed as the priority sector-lending program. The ratio has been increased from 5 to 7 percent of the total deposits. The directed lending has been tied up with the total loans since 1984 and the commercial banks are directed to extend at least 8 percent of their total loans to the priority sector. In 1990, it was increased to 12 percent. Since 1991/92, the commercial banks have been directed to extend a certain percent of their total loans to the deprived sector. But gradually priority sector loan was phase out and concern only in deprived sector lending and such policy. (Unified Directives of NRB no. 17) is designed to provide financial access for proper and weaker section of the country through micro credit. Initially it was introduced in 1990 for 'A' class financial institution (commercial Banks). It is enhanced and made compulsory to compliance 'B' and 'C' class institution as well. As per Unified directives, banks and financial institution are mandatory to extend the certain percentage of their outstanding loan to the deprived sector. commercial banks hold extend 4.5% Development banks should expend 4% and financial institutions should expend 3.5% (Unified Directives of NRB 2072 no. 17) of their total outstanding loan to the deprived sector (NRB, 2015).

The Deprived sector includes the low income people especially socially deprived women, endogenous, lower caste, blind & hearing impaired, disabled, craftsman, artisan, small and marginal farmer and landless people. From the very beginning, these people are excluded from the formal banking services. Basically, the lending to those 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 productive sector lending for the year 2013/14, on an average, is approximately 13.5 percent, which was 11 percent in 2012/13 which is still below the minimum regulatory requirement of 20 percent. The deprived sector lending of commercial banks, for the fiscal year 2013/14 is 5.28 percent, which was 4.78 percent in the FY 2012/13. The deprived sector lending is above the NRB minimum requirement of 4.5 percent in the review year. These types of credit are popularly known as micro finance as well. Most of the countries of South Asia have implemented such policy regarding deprived sector lending under the initiation of central bank. The expensive of microcredit or micro-loan must know internationally began in 1976, in Bangladesh, an Asian country with extremely poor population, on the initiative of a university professor called Muhammad Yunus, (2015).

Nepal Rastra Bank, the central bank of Nepal was established in 1956 (2014 B.S.) under the Nepal Rastra Bank Act 1956 (2013 B.S.). It has become functioning as the government's bank and has contributed to growth of financial sector. Central bank is the main apex body of the banking and financial institutions which controls the entire currency and credit of the economy. Nepal Rastra Bank, the central bank of Nepal regulation, inspects, supervise and monitor the whole function of the bank and finance companies of Nepal. The second commercial bank, Rastriya Banijya Bank was established in 1965A.D. The inception of Nepal Arab Bank (renamed as Nabil Bank Ltd.) in 1984 A.D. is a first joint venture commercial bank proved to be a milestone in the history of commercial banking. Government of Nepal adopted a policy for allowing foreign joint venture commercial banks to operate in Nepal. The policy targeted to encourage the traditionally operated local commercial banks to enhance their capacity building, competitiveness and efficiency and modernize their function to give prompt customer service. Now commercial banks act and liberalization policy of 1980's there are at present 28 commercial banks operating in Nepal with the objective to encourage efficient banking services to increase foreign investment in the country and to bring healthy competition in the banking sector till 2016 (NRB,2016).

a) Prabhu Bank Limited

Prabhu Bank Limited was phenomenal, especially after merger of Grand Bank Nepal Limited, Kist Bank Ltd, Prabhu Bikash Bank Ltd, Gourishankar Development Bank Ltd and Zenith Finance Ltd in, 2016, attaining the status of “A” Class financial institutions licensed and regulated by the central bank of Nepal, Nepal Rastra Bank.

The Bank has completed years of journey since the inception and has accommodated seven different financial institutions in its making. The bank has a network of 137 branches and 126 ATMs across the country, making it premier private bank in terms of geographical reach and clientele segments with customer base of 850000 among the private sector commercial banks in Nepal. As the leading banking and financial services group in Nepal, the bank will be there where growth is, connecting customers to the opportunities, enabling business to thrive and economics to prosper and ultimately helping people to fulfill their hopes and realize their ambitions.

The environment of Nepalese banking sector is undergoing a rapid transformation. With liberalization in finance markets and integration of domestic market with external markets, bank operations have become more complex and dynamic. They are geared to meet the challenges and keep abreast the challenges.

The vision statement of the bank describes the core value and purpose that guide the bank as well as an envisioned future. Fundamentally, in all dealing PBL earnestly believes in transparency, financial soundness, efficiency and better technology.

Prabhu Bank's vision is to be financially sound, operationally efficient and keep abreast with technological developments. The bank family believes customers focus is a core value, shareholder prosperity is a prime priority, employee growth is commitment and economic welfare is a sincere concern. The bank wants to be a leader among the banks of its age in Nepal by fulfilling the interest of the stakeholders and also to provide total customer satisfaction by way of offering innovative product and by developing and retaining highly motivated and committed staff. It directs all its efforts to move ahead with increased profits. The following mission statement is a guide to meet the vision of the bank.

As a first step, Prabhu Bank will strive to be in a leading position amongst the banks of its ageing term of profitability, productivity and innovation. Prabhu Bank aims at total customer satisfaction by rendering efficient and diversified financial services through improved technology. Prabhu Bank will build a highly motivated and committed team of staff by nurturing a good work culture to achieve supervisor individual performance aiming to enhance organizational effectiveness. Prabhu Bank will be the place of pride to all its stakeholders.

b) Nepal Rastra Bank Act, 2002

This Act defines the role of NRB in formulating effective policies, developing secure, healthy and efficient payment system, regulating, supervising and inspecting banking and financial institutions and promoting and striving for a credible banking and financial system . It prohibits NRB to buy share of CBs or financial institutions. NRB, however, plays a developmental role through a special fund, the Rural Self-Reliance Fund (RSRF), which operates with an interest rate below market rates. NRB's financing role through RSRF undermines the steady development of other apex institutions in rural and microfinance sector. The justification for continued operation of RSRF is based on the need for serving weak institutions that cannot meet the eligibility criteria of other wholesale lending institutions.

c) Bank and Financial Institutions Act, 2006

This umbrella Act "Bank and Financial Institutions Act" (BAFIA) came into force in 2006 and it replace the Bank and Financial Institutions Ordinance (BFIO) of 2004. All the commercial banks, development banks, finance companies, microfinance development banks are regulated under this umbrella act as Class A, Class B, Class C and Class D institutions, respectively. A small Microfinance Development Bank (MFDB) can be established with a paid up capital of Rs. 10 million to operate in three districts outside Kathmandu Valley. For operating in 4-10 districts outside Kathmandu, the MFDB has to have paid up capital of Rs. 20 million and for a national level MFDB the paid up capital must be at least Rs. 100 million. MFDP can increase the number of districts if it could increase paid up capital. For adjoining additional districts, it requires to increase paid up capital by Rs. 2.5 million. The promoters can retain 70% of the share capital and they must float the remaining 30% share to the general public. An MFDB operating of 10 districts with a capital of Rs. 20 million can operate in other five districts in the hills without any additional capital. This umbrella Act has a provision for even a foreign bank or financial institution, in joint collaboration with a Nepalese organization or citizen or through its subsidiary organization having its full share, can provide microfinance services in the country with the permission from NRB and the Government of Nepal. Under this act, NRB has the responsibility to supervise, warn the Board of Directors and even take over management in case some wrong things happen to a bank and also initiate actions for liquidation if required by circumstances.

d) Cooperate Societies Act, 1992

The Cooperate Societies Act was introduced in Nepal in 1992. Under this act, cooperates can be formed with 25 persons as members. These autonomous institutions are entitled to formulate their own by lows or operational procedures through their General Assembly (GA) meetings. Each cooperates will have Board of Directors and an Account Committee(AC) consisting of members duly elected by the members through General Assembly using one man one vote principle. The term of Board members and members of Account Committee (AC) is also determined by the GA but not exceeding 5 years. The Board appoints the management team or prescribes other body that carries out the day-to-day activities of cooperatives. The AC is responsible for internal audit and accountable to General Assembly for accounting and financial operations. Under the act, the Department of Cooperatives is fully authorized to register, supervise, appoint auditor, take necessary actions for improvements and reforms and liquidate all types of cooperative societies.

e) Financial Intermediaries Act, 1998

In 1998, NRB introduced the Financial Intermediaries Act in order to regulate the financial intermediary NGOs carrying out microfinance activities. This was claimed to be a significant step in the boosting up NGOs to undertake microfinance activities for the poor. However, this Act did not permit FINGOs to accept saving deposits from their clients, which is a considered to be a vital aspect for sustainable operation of microfinance services. Consequently in 2001, this act was amended allowing FINGOs also to accept saving deposits from their members. According to this Act, an NGO intending to carry out microfinance activities is required to obtain license from NRB. The FINGOs need to maintain a minimum of Rs. 100,000 as their capital to get license. After receiving license from NRB, they can apply for funds from the wholesale lending institutions, such as RSRF, RMDC and Commercial Banks. The FINGOs are required to renew their license every two years. The NRB is responsible for supervision of the FINGOs to ensure that they are performing well to the interest of the target groups and the institutions that provide them financial support.

f) NRB's prudential regulation for MFDBs

Details of NRB's prudential regulation for MFDBs are presented below.

i). Capital Requirement: A minimum of paid-up of NRs 100 million is required to open a MFDB at national level. Similarly , MFDB which is to be operated within 4 to 10 districts excluding Kathmandu valley requires NRs 20 million as its minimum paid-up capital. The lowest capital requirement for MFDB is NRs 10 million and such MFDB can operate with the coverage of 3 districts including Kathmandu valley.

ii). Limit for Promoter's Stake: A minimum of 15 promoters are required to promote an MFDB. The promoters of MFDB can hold a maximum stake of 70 percent. At least 30 percent shares should be allotted to the general public, which should be issued within 2 years of the operation of the bank. The promoter can off-load their stake with the permission of the NRB after meeting the following two conditions: (a) public issue has been done; and (b) listing of shares at the Stock Exchange has already been done for the last 3 years.

iii). Provision for Foreign Stake Holding: Foreign institutional investors can hold a minimum of 20 percent to maximum of 85 percent stake at the MFDB. However, such stake should not affect the public allocation i.e. 30 percent if the foreign investment is less than 50 percent. If foreign investment is equal or greater than 50 percent of the total paid-up capital there should be a provision of 20 percent for public allocation. But foreign individuals are restricted to have equity in MFDB.

iv). Individual Share Holding Limit: Any individual, firm, family and group, house, company falling in the same group cannot hold more than 15 percent share of MFDB. Such limit is also applied to the promoters.

v). Licensing Procedures: If the proposal for establishing MFDB is found technically and financially viable, NRB will issue banking license such MFDB within four months of the application submitted with cash deposit to NRB by the promoters. An amount equivalent to 20 percent of the promoter's shares should compulsorily be deposited with the NRB's account at the time of application. Another 30 percent of such amount should be deposited at the time of receiving "letter of intent" from the NRB. The remaining 50 percent of the promoter's commitment should be deposited at the time of getting business license from the NRB. The NRB does not provide any interest on such deposits. On the other hand, if the proposal is found nonviable, and the promoters could not submit the required documents and also they failed to deposit cash amount within the timeframe given, the NRB will reject such proposal and notify to the applicants within the timeframe as mentioned above.

vi). Graduation of MFDB: AMFDB (that presently falls under grade D) can be graduated if it fulfills all requirement for upgrading from grade 'D to C' and so on to grade 'A'.

vii). Priority for License: A MFDB, to be operated in rural areas, is given top priority for business license by the NRB.

viii). Other Prudential Regulation: NRB has introduced, with effect from mid-April 2003., prudential regulation for MFDB operating in the country with an objective of making micro-finance business more viable and sustainable as well as competent and effective in delivering services.

1.2 Statement of the Problem

Micro-finance in Nepal is emerging and transforming itself from directed regime to market led private effort over the years, although there are different legal and regulatory provisions for different groups. Due to the various stakeholders and microfinance players we cannot find such single framework related to Nepal's national microfinance policy. Nepal Rastra Bank is continuing since last few years towards the development of consensus on micro-finance policy. But Nepal Rastra Bank is recognized as systematizing, regulating, supervising, promoting and facilitating the system, methods and institutions. Nepal Rastra Bank is considered as one of the prominent regulator, which always is in support of poverty reduction strategies through the provision of development finance especially micro-finance. On the other hand, there are different legal provisions for different players in microfinance field. Cooperative Act and Financial intermediaries Act also actively influenced the microfinance activities which is not directly supervise by central bank. The different regulatory body regulates those institutions. The policy framework is also reviewed time to time as per need and stakeholders feedback. Government and NRB provide special attention to collect data, information and other related issues. On the basis of mentioned fact, this study is directed to resolve the following issues:

1. What is the trend and patterns of directed lending of Prabhu Bank Limited?
2. What is the contribution of Prabhu Bank Limited on directed lending?

1.3 Objective of the Study

Highlighting the above literature and current provision regarding the deprived sector loan, the specific objectives of the study are derived as follows:

a. To examine the trend and patterns of directed lending of Prabhu Bank Limited.
b. To analysis the contribution on directed lending of Prabhu Bank Limited.

1.4 Significance of the Study

The directed lending 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 an imperative aspect of poverty alleviation efforts. Banks, development banks and finance companies are main source of financial resources of the country. Financial institutions are focused and able to render services at easy accessible region only. It implies that poor people are still rely on merchants, money lenders, traditional cooperatives and other financial groups to meet financial needs. This indicates that the needy group has no option to bear comparatively higher cost to obtain such services. The regulator (or Government) has derived the main objective of deprived sector credit is to uplift the socioeconomic status of poor access less and deprived class of society. The significant amount is allocating to lend deprived sector lending after including B and C class institutions. But the proper utilization of such fund is always questionable. It is universal fact that there are various problems and obstacles has played vital role to successful implementation of micro finance activities. Despite of various endeavors, Government unable to get success to reduce poverty significantly because the different economics report has described that the level of poverty in Nepal is in decreasing trend. On the basis of mentioned fact, this study will play important role to resolve the issues.

1.5 Limitations of the Study

Due to various this research work is not able to study the whole aspect of microfinance as well as Deprived Sector Loan (DSL) impact. It is a fact that every study is not free from limitations. In the same way, this research study also has some limitations, which are enumerated below:-

i. This study is limited from the point of view to the submission impartial fulfillment of the requirement for the Master degree (M.A. in economics). So it is limited due to the time constraint, purpose and other necessities. Therefore it is not a comprehensive study it is presented specific issues regarding the selected topic in certain chapters.

ii. The core of this study is based on the secondary sources of information. Hence any error in the key information like data and other sources might affect the accuracy of the outcome of the study.

iii. This study has cover only seven financial year's data. This study is mainly focused on deprived sector loan policy issued by Nepal Rastra Bank. It has not represent the whole scenario of micro credit. It only helps to understand the volume of DSL provided to different targeted group and present regulatory provision and compliance level regarding DSL.

1.6 Organization of the Study

This study has been organized into five chapters. The study starts with the first chapter that includes general background of the study. It contains the general introduction of directed lending, indirect lending &micro finance of commercial banks in Nepal, brief profile of Prabhu Bank Nepal Limited. The statement of problem, objectives of the study, significance of the study, limitation of the study and organization of the study. The second chapter provides the clear insights of the literature reviews. Where two heads are includes. Which are theoretical review and empirical review. It incorporates review of theoretical related literature regarding the subject matter. Likewise, chapter third incorporates with the research methodology, which consists of research design, source of data and tools and techniques of data collection. These are used for the analysis of the presented data. Fourth chapter focus on Presentation and analysis of data using different statistical tools and major findings. It is the main part of the study. Similarly chapter five includes conclusion and recommendations and Final chapter includes summary, conclusion and recommendations regarding the subject matter. Recommendation is given on the basis of the analysis and findings drawn from the analysis.

CHAPTER - II

REVIEW OF LITERATURE

This chapter provides conceptual framework of the study and deals with review of various previous studies associated with deprive sector lending and its impact on poverty reduction as well as living standards of borrowers. It is divided into two sections. First section presents a theoretical framework of the study. Second section consists of an in-depth review of related studies in the context of regulatory framework related to deprive sector lending. This section also deals with a brief review of different research work in the context of Nepal.

2.1 Theoretical Concept

The conventional banking system in the developing world often fails to meet the loan target of the poor people. The major reason for not including the target of the conventional banking system is, the poor often have the lowest collateral substitute and credit plus services. Microfinance thus becomes distinct from other regular credit when not only the credit amount is small and the clientele is poor, but also credit is provided with collateral substitute instead of traditional collateral.

The deprived sector credit policy is directed credit policy of Nepal Rastra Bank, which is designed to meet microcredit 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 end up to 3%of their total loan outstanding to deprived people. Since the inception various policy reforms are carried out to enhance the effectiveness of the policy of the 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 is to uplift the socio-economic status of these people.

Nepal Rastra Bank has defined "deprived" means low income and especially socially backward women, tribal people, Dalit, hearing impaired and physically incapacitated persons, marginalized and small farmers, craftsmen, labor and landless squatters family. All micro-credits to be extended for the operation of self-employment oriented micro-enterprises for the uplift men of economic and social status of deprived sector up to the limit specified by this bank is termed as "deprived sector lending".

In Nepal, in order to expand the Micro credit services NRB has issued directives (no. 17, 2073) to banks and financial institutions to extend the loan of certain percentage of their outstanding loan to the deprived sector. Out of total outstanding loan of commercial banks should extend 4.5%, Development banks should extend 4% and financial institutions should extend3.5% of the total outstanding loan the deprived sector. The fund available for this provision has assumed to have significant impact on Micro financing for poverty reduction. Based on this compulsory in deprived sector, commercial banks have been provided Rs. 50892.3 millions, development banks Rs. 50890.3 million and finance companies Rs, 6, 34,534 thousands of deprived sectors in the year ended mid-July 2009. Similarly, by mid-July 2009, 15 micro finance development banks extended micro credit of Rs. 8,182,050 thousands to their clients.

2.1.1 Micro Finance

The word "Micro credit" (Micro finance) did not exist before the seventies. Now it has become a buzz-word among the development practitioners. In the process, the word has been imputed to mean everything to everybody. No one now gets shocked if somebody uses the term "Micro Credit" (Micro Finance) to mean agricultural credit, of rural credit, or cooperative credit, or consumer credit, credit from the savings and loan associations, or from credit unions, or from money lenders(Younus, 2007). Novel peace prizewinner Prof. Mohammed Younus has classified microfinance more broadly. It means that micro credit is a type of credit where poor, disadvantaged or marginalized farmer or people would have better access and have benefited. Various institutions and scholars have defined microfinance in different ways. Asian development bank (2000) has defined microfinance as "the provision of broad range of financial services such as deposits, loans, payment services, money transfer and insurance to poor and low income households and their micro enterprises.

Robinson (1935), microfinance refers to small scale financial services primary credit and savings provided to people who farm or fish or herd; repaired or sold; who provide services; who work for wages or commission; who gain income renting out small amount of land, vehicles, craft, animals or machinery and tools; and to the individuals and groups to the local level of developing countries both rural and urban.

Microfinance refers to all types of financial intermediation services (savings, credit funds transfer, insurance, pension remittances etc.) provided to low-income households and enterprises in both rural and urban areas, including employees in the public and private sectors and self-employed. (Robinson, 2003).

Above definitions state that microfinance is a kind of strategy to mainly to focus on the financial services to be provided to the low-income people to operate their micro enterprises. Microfinance enterprises are NGOs, saving and credit cooperatives, credit unions, Government banks, Commercial banks, etc. Microfinance clients are typically self-employed, low-income entrepreneurs in both rural and urban areas. Clients are often traders, street vendors, small farmers, service providers (hairdressers, rickshaw drivers), and artisans ad small producers such as blacksmiths. Usually their activities provide a stable source of income (often from more than one activity). Although they are poor, they are generally not considered to be "poorest of the poor". Moneylenders and rotating savings and credit associations are informal microfinance providers and important source of financial intermediations.

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 credit is known as a micro credit, which is primarily provided to cater the income generating activities. The various deprived sector credit policy related activities show that it has generated a positive impact on micro financing.

2.1.2 Poverty and Inequality in Nepal

In Nepal, the Seventh Plan took a basis need approach to reduce poverty and inequality. After the political change in 1990, the Eighth Plan had set an objective of poverty alleviation and set a long term vision to reduce poverty at 10 percent level at the end of Twelfth Plan. The Tenth Plan gave continuity of Ninth Plan objective and divided poverty into mainly three categories- income poverty, human poverty and social exclusion. The Three Year Interm Plan (2007/08-2009/10) set an objective to generate an experience of a direct feelings of change in the lives of the general public by supporting in the establishment of peace and reducing the existing unemployment, poverty and inequality in the country. The recent three year plan (2013/14-20015/16) has set an objective to enable people to feel change in their livelihood and equality in life by supporting poverty alleviation and establishment of sustainable peace through employment centric, inclusive and equitable economic growth.

2.1.3 Poverty Line

In Nepal, as in many other developing countries, the concept of an absolute poverty line is used. The first time in 1977, National Planning Commission had conducted a Household survey based on consumption and income. The poverty line was set to Rs.60 per person per month basis income. This survey found 40.3 percent population below the poverty line. In 1985/86 with different indicators and methodology, Nepal Rastra Bank had conducted the Multi-Purpose Household Budget Survey (MPHBS) and found the population below the poverty line was 42.5 percent.

To measure the poverty incidence, the Government of Nepal had conducted Nepal Living Standard Surveys (NLSS) in FY 1995/96, FY 2003/04 and FY 2010/11. Taking Rs.6606 as the average national poverty line as per the Nepal Living Standard Survey (NLSS) 2010/11, 25.16 percent of the population of Nepal falls below the poverty line. On the basis of Survey's benchmark of one dollar a day as per the purchasing power parity terms, 24.1 percent of the total population falls below the poverty line. When we doubled this international poverty line to "$2-a-day", the poverty incidence was estimate was 65.8 percent for 2010/11. Those NLSS Surveys, the number of population living below the poverty line in Nepal is reducing. The main reasons were found such as the increase in remittance income, increase in average wage rate in agriculture sector and the lower growth in inflation.

In 2010, same methodologies of NLSS and data from Nepal Labor Force Survey have been used and this Multivariate Analysis found the number of population living below the poverty line Nepal is reducing and reached to 25.4 percent. The revised the absolute poverty line to $1.25 a day by the World Bank, poverty incidence would be higher in Nepal. However, a multidimensional poverty index used by UNDP which covers education, health and living standard indicators, and 35% of Nepal's the population found below the poverty line in 2011. The consumption basket in NLSS III was changed, and result is forecasted as overall, 25.16 percent of Nepalese are below the poverty line. In rural areas, 27.43 percent people are below the poverty line. In urban areas, 15.46 percent people are below the poverty line.

Table 2.1: Trend in the incidence of Poverty in Nepal

Source	**Year**	**Population Below Poverty Line**		
		Urban	Rural	Nepal
Nepal Rastra Bank Household Survey	1985	19.2	43.1	42.5
NLSS I	1996	21.6	43.3	41.8
NLSS II	2004	9.6	34.6	30.9
Nepal Labor Force Survey (Multivariate)	2008/09	7.36	28.54	25.39
NLSS III	2010/11	15.46	27.43	25.26

Sources: Central bureau of statistics

Observation:

An increase in inequality between the incomes of the rural poor and the urban rich also hinders the poverty reduction and growth prospects. Fund is more attached in the area where return to capital is higher and/or cost of lending is lower. This creates budget insufficiency among MFIs to reach the ultimate poor living in the remote corners, which are left out. The poor in the market area where the loan funds could be turned over in quick successions easily absorb the limited funds.

2.1.4 Historical Background and Policy Initiation

Nepal has developed considerable history in the provision of microfinance services as evidences by emergence and growth of a large number of microfinance institutions (MFIs) and microfinance programs during last decades. Formal microfinance in Nepal emerged in 1956 as cooperatives started providing savings and micro credit services to their shareholders. Government also recognized the potential role of microfinance services on addressing poverty problems and in 1975, the Agriculture Development Bank of Nepal (ADB/N) launched Small Farmers Development Project (SFDP), as a first project to introduce the concept of group guarantee as a substitute to physical collateral for micro lending (NRB, 2005).

Priority sector lending model was introduced in early 1974 though the mandatory credit requirement as put forward by the NRB in agriculture, cottage industry and services sector. This mandatory requirement is presently called Priority Sector Credit Program (PSRP) and Deprived Sector Credit Program (DSRP). Priority Sector Credit Program was renamed later as Intensive Banking Program (IBP) IN 1981 while Deprived Sector Credit Program was introduced in 1991 by NRB. Both the programs have provision of direct and indirect financing. Under the direct financing mechanism, commercial banks provide loan to the beneficiary directly as retail lending while under the indirect financing, commercial banks act as wholesale micro-finance and the loan-able funds are channeled through MFIs, co-operatives, FINGOs and N\MFDBs for on-lending to the beneficiaries. Notwithstanding the fact that Nepal is currently passing through a World Bank led Financial Sector Reform Program (FSRP), NRB has opted for a phasing out policy of this priority sector credit program within 5 years starting from 2002/3. It may be recalled that mandatory requirement to flow funds into Priority Sector Credit Program was 12 percent of the total credit outstanding, while for commercial banks are required to finance micro finance sector at least to the tune of 3 percent of their total credit outstanding.

The official policy that recognized importance of micro finance sector of poverty reduction came in the Sixth Plan (1980/81-1984/85) and then-after both government and non-governmental sector developed and implemented number of program to ensure access to formal credit to the poor; particularly to the poor women. The microfinance sector gained momentum after 1990s where in number of MSPs increased exponentially with the entry of local NGOs and Microfinance Development Banks (MDBs) in the market. At present, four major types of MFIs namely saving and Credit Cooperatives (SCCs), Small Farmers' Cooperatives Limited (SFCLs), Financial Intermediary NGOs (FI-NGOs) and MDBs; and large number of SCGs are active in Nepalese microfinance sector. In addition to these MFIs, there are dozens of rural development programs with credit component to provide financial services to the poor. Despite significant innovations to extend financial services to the poor and excluded, microfinance services has been confined to a grated extend among small relatively less poor segment of rural population living in accessible districts and large number of poor and vulnerable poor living in remote hills and mountain districts are yet to be services through microfinance services. After documenting the context and realities on microfinance operation and landscape of Microfinance Services Providers

(MSPs). This research review the product and service delivery methodologies, outreach, cost structure, efficiency and productivity and portfolio quality of leading MFIs and assesses their comparative advantages to expand the frontier of microfinance services in inaccessible hills and mountain areas.

Thus the government's direct and indirect interventions supported by donor assisted projects promoted the evaluation of the industry. Lessons learned from each initiative were used as a base when designing subsequent strategies (Dhakal, 2007).

Important initiatives in the microfinance sector implemented by the Government are:

i) Credit co-operatives established in 1950s.

ii) Co-operatives established in the 1963.

iii) SFDP established under ADB/N (1975).

iv) Commercial banks required following priority sector lending directives (1974).

v) The IBP involved commercial banks in micro-credits (1981).

vi) Gender based micro-credit -Production Credit for Rural Women (1982).

vii) Setting up a Rural Self Reliance Fund (1991).

Gender programs refined involving NGOs- Micro-credit Project for Women (1994).

viii) Replication of Grameen banking model (1992).

ix) Co-operatives act promulgated to support the credit co-operatives (1992).

x) Government -run MF programs- banking with the poor. Bisheswor with poor. Jagriti, Youth Self Employment etc.

Microfinance regulation is mainly under the Banking and Financial Institutions Act (BAFIA) and the Financial Intermediary Act. MFIs are categories as "D" type financial institutions under BAFIA and the prudential norms are designed in line with normal financial institutions. Government of Nepal announced National Microfinance policy 2064 on May 4, 2008, and prior to that there was no any formal policy as such. But informally or in scattered way government and NRB used to have various policy that governs microfinance operation such as Deprived Sector Lending promoting MF by government itself by way of establishing Grameen banks and emphasis cooperative development, etc. The policy seeks to assist in poverty reduction though stainable, simplified and access oriented microfinance services. The objectives of the policy are increase the access of microfinance services for poor and weak financial status family and women group and conducting income generating and employment generation work, make microfinance services reliable and accessible through MFIs, help microfinance services supplying organizations to develop required capacity to be established in sustainable and self-capable manner, formulate required law related to microfinance and develop appropriate institutional mechanism to increase the microfinance services send to make such services disciplined. Microfinance providers have faced major challenges in extending their services to remote areas. Outreach of microfinance services has been stagnated in recent years as their expansion has been impeded among other by security concerns and lack of proven micro-lending methodologies (Dhakal, 2007).

2.2 Empirical Review

a) International Context

Directed Credit Program involving loans on preferential terms and conditions to priority sectors was a major tool of development policy in both developed and developing countries in the 1960s, 1970s and mid-1980s. Even though Japan and other East Asian countries supported well managed and focused directed credit program, the experience of most countries around the world showed that directed credit program suffered from abuse and misuse of preferential funds from non-priority purposes, increased the cost of funds to non-preferential borrowers involved a decline in financial discipline that resulted in low repayment rates, and contributed to the government being burdened by unpaid loans and huge arrears. Moreover, once introduced directed credit program proved to be difficult to discontinue.

During the late 1980s and 1990s, several countries adopted the stance of financial liberalization and deregulation of interest rates. Market oriented financial and credit policies started to replace directed credit policies of the earlier decades. It was not until recent years that the government with weaker economic and institutional infrastructure have adopted a more non-traditional and liberal approach. I.e. microfinance. The recent experience of developing countries likes Bolivia, Bangladesh, Indonesia and the Philippines to name a few, in microfinance has shown its significant function in creating access to financial services by the poor.

In developing countries, the vast majority of people do not have access to basic financial services. In India, about 73 percent of the 89 million farming households have no access to formal sources of credit. Likewise 79% of the households do not have access to formal loans and 59% do not have access to savings account in the formal sectors. The access problem is more severe for the poorer households in India where 87% of the poorest households have no access to a loan and 71% have no access to a savings account from the formal financial system. In Pakistan, about 30% of adults have bank accounts and total owners from banking institutions are only 3% of the population, where there are only 171 deposit accounts and 30 loan accounts per 1000 people. Likewise agriculture, small and medium enterprise credit reaches only 1.6 million and 0.3 million borrowers, respectively. The high economy boom country of the present world, The People's Republic of China (PRC) also does not have a satisfactory record for access to financial services. The Organization for Economic Cooperation and Development (OECD) 2004 reports that only 16% farmers in the People's Republic of China (PRC) has accessed to formal or informal credit.

b) Nepalese Context

Although microfinance practices in Nepal started as early as in 1974, efforts in creating legislative and regulatory environment for this sector were made possible only after the introduction of Development Bank Act-1995 and Financial Intermediary Act-1998. Nepal Rastra Bank introduce with effect from mid-April 2003, prudential regulation for a micro- finance development Bank (MFDB). This regulation with effect from the fiscal year 2005/06 has made further amendment in some areas. Presently, there are Thirty six MFDBs in operation. There are two separate legal frameworks for microfinance business, whereas Financial Intermediary Act-1998 (1st Amendment 2002) facilitates FINGOs for doing limited financial intermediation like small savings, group savings, micro-credit and agent banking. With the introduction of BFI Act (now BAFIA-2063) all micro finance development banks fall under category 'D' financial institution.

Adhakari (2013), has analyzed the loan disbursement and repayment pattern of SFDP and Impact of SFDP in uplifting the social-economic and institutional development in Nepal. This study is based in secondary data. The methodology adopted in his study are as follows: to examine the loan disbursement and repayment pattern of SFDP in Nepal, to analyze the impact of SFDP in uplifting the socio-economic condition of people, to evaluate the institutional development in Nepal through SFDP and to recommend necessary suggestion for better improvement.

The study concluded that SFDP has completed twenty years of its operation as major poverty alleviation strategy in Nepal. Experience gathered over the years through the process of implementation of the SFDP. SFDP Philosophy has been successful in directing the basis development services to the target population and it could be one of the effective poverty alleviation strategies in the country. So keeping in view the extent of rural poverty in Nepal. It is straggly needed that the SFDP should be rapidly expanded to cover the large population of the needs small farmers all over the country. During twenty years of continuous operation it has been suffering from various operational as well as implementation weakness. The overhead cost of SFDP in increasing, the loan repayment rate is deteriorating, supervision and coordination of SFDP have become vague and complicated and above all the group as well as "Planning from below" concept of SFDP was deviating from its basis principle in practice.

Rai (2011), has analyzed the institution development program of SFDP and the overall situation of SFCL, achievements of the SFCL on the basis of financial and social indicators. The study is based on secondary data. This study has following objectives: to study about the institution development program of SFDP and the overall situation of SFCL, achievements of the SFCL on the basis of financial and social indicators, to study about the decision and leadership skills of the small farmers and to forward suggestions and recommendations of the SFCL programs on the basis of findings.

The study concluded that there is a significant contribution of SFDP on the collection of principal as well as interest from agricultural loan through it is argued that the operating cost is relatively high in SFDP. The SFCL had increased recovery rate over the period. However they have not been able to keep up with the same pace of loan disbursement and has been increasing every year at increasing rate. Most of the farmers were interested in SFCL due to its integrated service. The SFDP programme has been contributing on social service area. However, contribution is found in group saving, plantation of tree and the distribution of highbred seed.

Bhattrai (2012), has analyzed the loan disbursement and repayment pattern of SFCL and Impact of SFCL in uplifting the socio-economic condition of farmers. This study is based on primary and secondary data. The major objectives of this study are as follows: to examine the loan disbursement and repayment pattern of SFCL in Juropani VDC, to analyze the impact of SFCL in uplifting the socio-economic condition of famers before handover of handover of Juropani VDC of Jhapa district, to evaluate the economic impact of SFCL in the study area, and to recommend necessary suggestion for future improvement.

The study concluded that the maximum loan has been distributed on cereal crops, which are 33.76 %. Similarly, the second field, loan disbursement has been given on cash crops, which are 14.02%. So it can be concluded that the farmers are more interested in the production of cereal crops and cash crops rather than the other activities. The highest proportion of loan collection sectors, Agro-tools, marketing and livestock which are 32.07%, 14.87%, 12.44%, 11.45%and 10.61% respectively. Likewise the lowest proportions of loan collection sectors are irrigation Bio-Gas and cottage industry which are 1.95%, 1.98% and 2.04% respectively. After handover of the program average days of employment of small farmers have increased because of successful participative program implemented by the SFCL. After handover of the program, the formulation of the group has increased from (85 to 105) similarly coverage of members (male as well as female) has increased from 510 to 805. In spite of its popularity, there are still some corners, which are criticized by non-participating small farmers. Out of total 40 respondents the cause of non-participation is 40% due to lack of knowledge, 25% due to difficult procedure and 15% due to difficulty in group formation. In overall, it can be concluded that the performance of SFCL Juropani is very satisfactory after handover of the program.

Niraula (2014), has concerned in the credit policy, loan investment, collection outstanding and delinquency of SFCL Bahundangi, the main objective of the study is to find out the performance of in Bahundangi VDC. The specific objectives of the study are as follows: to find of the existing financial position of SFCL, Bahundangi, Jhapa, to analyze the trend of the financial institution, to analyze the growth pattern of organization and to provide reformative suggestion for future improvement.

The major findings of this study are: In the study of balance sheet of SFCL, it was found that over all assets of SFCL Bahundangi is increasing year by year. The total increase amount from Rs. 14681 thousand to Rs. 40778 thousand from F/Y 2060/61 to F/Y 2070/71 respectively. The increased percent is 178 percent. This shows the positive performance of the institution. In the study of overdue loan ratio and non-performing assets ratio it was found that both are increasing order, this shows the non-satisfactory result. Operating cost ratio was found 0.94 percent, 0.68 percent 1.28 percent and 1.2 percent respectively from F/Y 2068/69 to F/Y 2070/71. It has got 1.32 percent average ratio. Repayment ratio was found 69 percent, 52 percent, 21 percent, 23 percent and 17 percent respectively from F/Y 2068/69 to F/Y 2070/71. It had got 30 percent average repayment ratio. It was also in decreasing trend and unfavorable for the organization. Interest receivable was found increasing trend from Rs. 1470 thousand at Rs. 10407 thousand respectively from F/Y 2068/69 to F/Y 2070/71. Outstanding loan was found gradually increasing trend from Rs. 10510 to Rs. 18807 during the study period. Increase of outstanding loan showed the positive result.

Ghimire (2014), has concerned to identify the performance of SFDP for the rural development, increase in productivity, income and quality of life of the poor through the rural financing. The specific objectives of the study are as follows: to identify the performance of SFDP for the rural development, to analyze the increase in productivity, income and the increase in the quality of life of the poor through the rural financing, and to find the level of rural financing and rural saving mobilization through SFDP.

The study concluded that positive impact of the SFDP was seen in the use of improved farming methods such as increase in cropped area, use of improved seeds and fertilizer and other input. It has positive impacts in the chains of social development front as SFDP performs different social development activities for poor people. The SFDP have contributed significantly on the development of the income level of rural poor farmers. Principally it functions mainly as a rural development by providing different credits to its member groups. The ultra-poor people, utilizing it for agricultural production and marketing, increase their employment and income level. In order to promote the income level of rural poor, the SFDP had played a significant role in order to improve the living standard of poor people. The low income group benefited, as they got small credit at the subsidized of interest.

Professor Yunus, Nobel Peace Prize winner in 2006, institutionalized his vision of microfinance by establishing the German Bank in Bangladesh (1983). The German model is popular in the microfinance world because of its specifies characteristics i.e. targeted to serve the poor, survive available through doorstep service, loan are collateral free, there is good repayment rate, lending focused on women, finance are managed by banking professional and the strong impact of marginalized groups (Khanal, 2014).

The same microfinance system was introduced in Nepal in the early 1990s when the Central Bank established five (5) rural regional development banks. Development workers around the world have been emphasizing the microfinance as effective tool for poverty reduction and it became popular in Nepal also. The respondents of the microfinance service providers are usually poor and low income households living in remote area without access to basic facilities the saving and investment of the rural poor population is low earning. To stimulate the growth of saving and investments and eliminate the gap between saving and investments, there is need of rural finance. Since poor people cannot afford large amount of financing. Micro financing is the only tool that can meet the financing need of the rural people. Despite of various endeavors, the outreach of financial institution has covered only 30-35% of population remaining 65-70% of the population relies on informal sources of financing. The formal microfinance service providers are only able to extend their MF services to 56 districts where as 19 districts are not assessed to formal financial services in Nepal as of mid-July 2009with in the covered districts also the financial institutions are able to rendered services at easy accessible regions only. It implies that poor people in Nepal still rely on merchants, money lenders, traditional cooperatives and other informal groups to meet the financial need, which cost high to them (Thapa, 2014).

NRB in its regulation defines the loan up to rupees 60000.00by microfinance development banks (MFDB), as micro credit, similarly RSRF recognizes loan up to Rs. 60000.00provided per borrower given to the deprived sector as the micro credit and a group loan up to 150000.00 given to the members of joint liabilities for project loans.

Dhakal and Kanel (2014) studied of microfinance program, where analyzed the state of microfinance services in insurgency-affected areas, especially in relation to outreach operational and financial performance and portfolio quality and staff productivity. Researcher used the three paradigm of empowerment to study.

a) Feminist empowerment paradigm
b) Financial self-sustainability paradigm
c) Financial self-sustainability paradigm
d) Poverty alleviation paradigm

Researchers mentioned the role of microfinance in woman empowerment is significantly increasing incomes from women’s activities and increasing choice of these activities. Enabling women to control (have a choice over use of) incomes from loans and activities generated by loans. Enabling women to negotiate improvements in their well-being within the household.

c) Some Practices of Commercial Banks in Micro Lending

i) NMB Bank

In commercial Bank History, NMB Bank has set record of dramatic growth within the timeframe of last six years. With the Bank's growing portfolio, it was obvious to grow microfinance multi-dimensionally in terms of structure, working modality, added responsibilities, multi-task with innovation and area of coverage. In the other hand, the mandate to liaise with Nepal Rastra Bank's strictly focused on its micro-banking services. NMB Bank has been providing microfinance services in two ways- wholesale lending and retail sales. For wholesale lending, the bank has entered into an Agreement with several Micro Finance institutions (MSIs) in the country. MFIS are the middlemen Between the Bank and the people, and help to provide the bank's services to people in rural areas of the country where the ban is not present. In addition to that, through MFU, the bank is itself taking the services to the people in need. The Bank has mobilized its branches and staff to serve the financial requirements of low income people and continues to invest in the skill of people by providing collateral/non-collateral loans to clients on group guarantee basis, with reasonable interest rate to provide them the foundation for employing their skills in productive work. Farmers, small household entrepreneurs and artisans are the major beneficiaries of the bank's services. Further, the Bank continues to endeavor towards empowerment of woman by means of financing their skills and encouraging entrepreneurship to gain semblance of financial independence.

Source-(http://nmbbanknepal.com/micro-finance.html)

ii) NIBL Ace Capital (October, 2017)

Microfinance is a financial service aimed at low-income individuals or at those who do not have direct access to typical banking services. Microfinance encompasses a number of financial services like micro-credit, micro-lending, micro-insurance, savings and money transfer among others. A microfinance institution (MFI) provides financial services to the communities who cannot offer collateral against the loans they take but have skills and desire to undertake economic activities for generating income and self-employment. MFIs range from small non-profit organizations to commercial banks. Based on the concept that access to financial services can help elevate low-income individuals out of poverty, microfinance programs are implemented in Nepal with a strong rural alignment, especially aiming at the poor.

With the history of quite a few decades, MFIs in Nepal have been following a few prominent microfinance models. These comprise of Cooperative model, Small Farmer Cooperative Limited (SFCL) model, Grameen Bank model, and Community based organizations (COs) or Self-Help Groups (SHGs) model. In addition, Village Bank (VB) is also considered a separate program/model of microfinance in Nepal.

iii) National Microfinance Policy 2008

The Government has issued a National Microfinance Policy 2008, which envisages formulating separate institutions under the direct supervision of NRB in order to regulate, supervise, monitor and evaluate microfinance services by making providers self-disciplined and managing the necessary institutional and legal provisions needed for sustainable and simplified microfinance services. The ensuing legislation under the new policy should ensure creation of a conductive environment for microfinance institutions to operate efficiently and effectively, and to expand their outreach to the poor and disadvantaged throughout the country. On the advice of the Nepal Rastra Bank promulgated "National Microfinance Policy, 2008" in order to do any with the problems related to organizational and legal issues with a view to smoothly providing microfinance services in the rural areas, increasing the access of the destitute class to such services, creating a healthy and competitive atmosphere among MFIs and encouraging the private sector to get involved in the task of providing such services on a sustainable basis, Microfinance Policy, 2008 was introduced as anew mechanism to boost up microfinance industry. It aims to improve the smooth flow of fund to the poorest segment of the rural populace by creating national fund for microfinance. It also has envisaged establishing a regulatory and supervisory body for regulating and supervising the MFIs in the country as such that that discharge their services effectively and efficiently. The highlights of the policy are as follows:

Enhance the supply of microfinance services to the rural and urban poor to suit their geographical, social and economic diversity.

Improve the smooth flow of microfinance services with or without collateral (group guarantee) to the poor and the destitute by establishing a standard procedure for identifying the target groups.

The government will provide necessary help to the microfinance institutions for social mobilization, capacity development, organizational development, restructuring, and also will encourage wholesale micro credit providers both from as well as private sectors.

The government will also integrate microfinance with various poverty alleviation programs and projects and implement these in a coordinated manner.

The government will establishment relations with microfinance service providing institutions (MFIs) such as Community Organizations (COs), and saving and Credit Groups (SCGs), by making a legal provision to easily recognize these MFIs.

The government will also motivate destitute class to mobilize their savings in order to improve their access to microfinance services.

The government will make the necessary institutional and legal arrangements, and create a separate institution under the direct control of NRB to make the microfinance service providers (MFIs) self-regulatory for timely operation, monitoring, supervision, and evaluation such that they can provide microfinance services to the poor in a sustained manner.

In order to mobilize resources for long term easy access of the poor to the microfinance services a "National Microfinance Development Fund" will be established. Assistance for microfinance from foreign and national donors will be mobilized through this fund.

Conduct a survey to exactly know the existing number of cooperatives and microfinance institutions, extensions of services and access to services.

Organize trainings to improve the capacity of people engaged in microfinance sector.

Adopt the policy of relaxation in permitting saving deposits to the MFIs based on the services they provide and their share capital status, and adopt the flexible tax policy on income of the MFIs and tax on interest earnings of the poor.

Most of the initiatives and actions envisaged under the policy are yet to be observed. NRB, the central bank has been working on a draft to bring out a microfinance act also to create a regulatory and supervise the MFIs in Nepal.

2.3 Research Gap

Many thesis and articles working papers were studied for review of literature. Almost all studies explored that micro lending plays crucial role for improvement of economic status of rural peoples along with their life style. Some studies explored that there is direct relationship between micro lending and improvement on life style of rural peoples, as well as their long term impact on balance sheet of microfinance from deposit and lending part which is contribute by rural peoples.

There is gap between previous study and this study. All previous studies are primarily concerned on micro lending of different banks &micro finance companies but this study is purely concern on Prabhu Banks' Micro lending and Contribution of Prabhu Banks' Micro Lending to the deprived peoples.

CHAPTER - III

RESEARCH METHODOLOGY

Research methodology sets out overall plan associated with a study. It provides a basis framework on which the study is based. Before presenting the analysis and interpretation of data. It is necessary hat research methodology be described first. In the absence of methodology, it is likely that the conclusions drawn may be misunderstood. This chapter therefore explains the methodology employed in this study. For the purpose of achieving the objectives of the study. The applied methodologies are used. The research methodology used in the present study is briefly mentioned below.

3.1 Research Design

This research is descriptive types of research. The study being more related with the policy framework review of existing policy and regulatory framework of Nepal was done extensively. Available literature on principles, issues and practices of regulation and policy framework of some other countries were also reviewed as part of analysis. Thus the study was conducted on the basis of secondary information. The study focused on previous relevant study in Nepal and other countries to assess the effectiveness of directed lending as overall microfinance prospective.

3.2 Nature and Sources of Data

This study is based on secondary sources of data. The secondary sources of data have been employed to understand the historical behavior of the target group and the effectiveness of overall micro credit including deprived sector lending. It also helps to observe relation and to predict the possible impact from various implemented policy. The study has been more focus on regulatory framework prescribed by Nepal Rastra Bank with respect to deprived sector loan. Available literature on principles, issues and practices of regulation and policy framework of some other countries has reviewed as part of analysis. Data related the study has been obtain from central bank, concerned participating banks Prabhu Bank Limited and financial institution and other relevant study and reports. Thus the study has been conducted on the basis of secondary information.

3.3 Data Collection Procedure

The data related to micro finance including deprived sector lending is collected from concerned Prabhu Bank Limited, Central Bank and various articles regarding the issues. For observing the effectiveness, the different social indicator and data related to poverty and living standard status is explored from National living standard survey and other related study.

3.4 Data Analysis Tools

Before analyzing the data, the data and information have been presented systematically in the formats of tables which are explained a lot about the data and information collected.

3.5 Trend Analysis

In this analysis the past trend is analyzed of any data and future movement is predicted. A widely and most commonly used method to described the trend is the method of least square.

CHAPTER - IV

PRESENTATION AND ANALYSIS OF DATA

4.1 An Overview of Nepalese Financial System

The history of financial system of Nepal was begun in 1937 with the establishment of the Nepal Bank Ltd. as the first commercial bank of the Nepal with the joint ownership of government and general public. Nepal Rastra Bank was established after 19 years since the establishment of the first commercial bank. A decade after his establishment of NRB, Rastriya Banijya Bank, a commercial bank under the ownership of Government Nepal was established. Chronological development of financial institutions in Nepal is reflected in table below.

Table 4.1.1: Growth of Financial Institutions

Types of Financial Institutions	Mid July											
	1980	1985	1990	1995	2000	2005	2007	2009	2011	2013	2014	2016
Commercial Banks	2	3	5	10	13	17	20	26	31	31	30	28
Development Banks	2	2	2	3	7	26	38	63	87	86	84	76
Finance Companies				21	45	60	74	77	79	59	53	47
MFDBS				4	7	11	12	15	21	31	37	38
SACCOs				6	19	20	17	16	16	15	16	15
FINGOs					7	47	47	45	38	31	30	27
Total	4	5	7	44	98	181	208	242	272	253	250	232

Source: NRB, Financial Statistics, 2016.

In the context of banking development, the 1980s saw a major structural change in financial sector policies, regulations and institutional developments. Government emphasized the role of the private sector for the investment in the financial sector. With the adoption of the financial sector liberalization by the government in 80's opened the door for foreign Banks to open Joint Venture Banks in Nepal. As a result, various banking and non-banking financial institutions have come into existence. Nabil Bank Limited, the first foreign joint venture bank of Nepal, started operations in July 1984. During three decades, Nepal witnessed tremendous increment in number of financial institutions. Nepalese banking system has now a wide geographic reach and institutional diversification.

Consequently by the end of mid-March 2016, although 232 banks and non-bank financial institutions licensed by NRB are in operation. Out of them, 29 are “A” class commercial banks, 76 “B” class development banks, 47 “C” finance companies, 38”D” class micro-credit development banks, 15 saving and credit co-operatives and 27 NGOs. In mid-July 2015, the commercial banks branches reached to 1682. Among the total bank branches 49.6 percent bank branches are concentrated in the central region followed by Eastern 17.4 percent, Mid-Western 9.0 percent and Far-Western 5.5 percent respectively.

4.2 Geographical Distribution of the loans

As on end of Poush 2072, region wise distribution of credit shows that 62% of the total loan has been concentrated in Kathmandu Valley. Such concentration seems to be very low in mountain region (0.5%). Tarai region (26.5%) and hill regions (11%) come after the Kathmandu Valley. Out of total loan of Rs. 735 million, Rs. 714 billion (97.1%) was disbursed in the urban area while Rs. 21 billion (2.9%) only was found to be disbursed in the rural area. Commercial banks have lent their 98.2% and 99% respectively. Microfinance sector has penetrated 37% of its potential market with highest penetration in Tarai (66%), followed by accessible hills (33%), inaccessible hills (9%) and mountains (6%) districts. The low market penetration is attributable to difficulties to reach minimum number of clients per SDU due to prevailing low population destiny and high poverty incidence. Provision of microfinance services to large number of un-served and underserved micro entrepreneurs and poor households living in remote areas where demand for such services is still huge is yet a challenge. Commercial MSPs have comparative advantage to extend their services in urban and densely populated peri-urban areas while that of

Community based MSPs are better positioned to serve even in remote areas. On the other hand, there are SCGs throughout Nepal but not fully used due to lack vision. The table shows the distribution of loans in Terai, Hill and Kathmandu Valley.

Table 4.2.1: Geographical Distribution of the Loans

Region		Commercial Bank		Development Bank		Finance Company		Total	
		Amount	%	Amount	%	Amount	%	Amount	%
Terai	Urban	147.157	26.2%	23,345	25.6%	10,655	12.8%	181,156	24.6%
	Rural	6,620	1.2%	7,317	8.0%	226	0.3%	14,163	1.9%
	Total	153,777	27.4%	30,662	33.7%	10,880	13.1%	195,320	26.5%
Hill	Urban	41,085	7.3%	22,436	24.6%	12,994	15.6%	76,515	10.4%
	Rural	1,483	0.3%	2,367	2.6%	418	0.5%	4,268	0.6%
	Total	42,568	7.6%	24,803	27.2%	13,412	16.1%	80,783	11.0%
Mountain	Urban	2,097	0.4%	223	0.2%	-	0.0%	2,320	0.3%
	Rural	675	0.1%	352	0.4%	31	0.0%	1,058	0.1%
	Total	2,773	0.5%	574	0.6%	31	0.0%	3,378	0.5%
KV	Urban	361,214	64.3%	35,051	38.4%	58,717	70.6%	454,947	61.8%
	Rural	1,359	0.2%	35	0.0%	128	0.2%	1,522	0.2%
	Total	362,573	64.6%	35.051	38.5%	58,845	70.8%	456,469	62.0%
Total	Urban	551,553	98.2%	81,019	88.9%	82,366	99.0%	714,938	97.1%
	Rural	10,138	1.8%	10,072	11.1%	802	1.0%	21,011	2.9%
	Total	561,691	100.0%	91,091	100.0%	83,168	100.0%	735,949	100.0%
Required DSL*		16,850.73	3%	2,277.27	2.5%	1,663.35	2%	20,791.35	3%

Source: Nepal Rastra Bank, 2016.

4.3 Actual Position of Deprived Sector Credit

All Banks credit exposure and actual position of Deprived Sector Lending (DSL) as of year 2015 is presented below:

Table 4.3.1: Actual Position of Deprived Sector Credit Amount in Rs. Million

Banks	6 Months prior Loan &	Required DSL (4.50%)	Actual Deprive	Lending in Sector	Excess/ Shortfall
	Amount	Amount	%	Amount	Amount
Nepal Bank Ltd.	39903.21	1750.64	4.61	1793.99	43.35
Rastriya Banijya Bank Ltd.	52177.83	2348.00	5.74	2993.20	645.20
Nabil Bank Ltd.	51396.96	2312.86	4.69	2391.52	78.66
Nepal Investment Bank Ltd.	52250.96	2351.29	4.63	2417.35	66.06
Standard Chartered Bank Nepal Ltd.	25116.49	1130.24	4.57	1147.11	16.87
Himalayan Bank Ltd.	43957.46	1978.09	4.50	1978.96	0.87
Nepal SBI Bank Ltd.	32732.89	1472.98	4.72	1546.04	73.06
Nepal Bangladesh Bank Ltd.	15982.23	719.20	4.79	765.26	46.06
Everest Bank Ltd.	47965.16	2158.43	4.56	2187.18	28.75
Bank of Kathmandu Ltd.	35879.22	1614.57	9.79	1748.51	133.94
Nepal Credit & Commerce Bank Ltd.	17607.69	792.35	4.94	870.08	77.73
NIC Asia Bank Ltd.	32802.37	1476.11	4.79	1572.79	96..68
Machhapuchchhre Bank Ltd.	25270.09	1137.15	4.83	1220.79	83.64
Kumari Bank Ltd.	21510.54	967.97	4.71	1013.80	45.83
Laxmi Bank Ltd.	21907.11	985.82	4.57	1001.96	16.14
Siddhartha Bank Ltd.	25524.97	1148.62	4.58	1168.38	19.76
Agricultural Development Bank Ltd.	57975.72	2608.91	11.89	6890.63	4281.72
Global IME Bank Ltd.	30116.18	1355.23	4.75	1430.05	74.82
Citizens Bank Int. Ltd.	20417.31	918.78	4.55	929.70	10.92
Prime Commercial Bank Ltd.	23858.42	1073.63	4.58	1093.89	20.26
Prabhu Bank Ltd.	31264.72	1406.91	9.08	1419.06	12.15
Sunrise Bank Ltd.	20819.10	936.86	4.56	948.81	11.95
NMB Bank Ltd.	17822.42	802.86	5.20	926.07	124.06
Sanima Bank Ltd.	17351.76	780.83	4.71	818.11	37.28
Janata Bank Ltd.	12949.56	582.73	5.05	653.68	70.95
Mega Bank Ltd.	14016.87	630.76	4.77	668.75	37.99
Civil Bank Ltd.	15565.57	700.45	5.33	830.29	129.84
Century Commercial Bank Ltd.	12337.23	555.18	4.81	593.84	38.66
Total	815480.06	36696.60	5.28	43019.82	6323.22

Source: Bank Supervision Report, 2016. 6 Months prior Loan

As per annual bank supervision report of NRB 2016, Nepalese commercial banks are required to disburse 4.5% of their total loan portfolio in the deprived sector as directed lending and the average deprived sector lending of the commercial banks stood at 5.28% in the review year 2016. According to data of Bank Supervision report, 2016 total 6 months prior loan of commercial banks had Rs. 815480.06, where Prabhu Bank Ltd. had Rs. 31264.72 million among the total commercial bank. if Commercial banks that fail to maintain the minimum requirement in deprived sector lending as prescribed by the NRB is penalized (Monetary). In the review year, Nepal Bangladesh Bank Limited has been penalized Rs. 677,920.79 in the first quarter for not complying with the norms of directed lending.

4.4 New Provision in Monetary Policy of Nepal Rastra Bank.

The current monetary policy has been forecasted following policies regarding deprived sector lending and micro finance activities.

a) The deprived sector lending requirement for BFIs has been increased by 0.5 percent and finance companies 4.0percent of their total loan in the deprived sector. In addition, the deprived sector lending will be redefined by including the commercial agriculture lending.

b) The limit for microfinance loan will be increased. Group members who have been using deprived sector lending from the MFIs for the last two years and categorized as good borrowers will be entitled to borrow up to Rs. 3,00,000 up from the existing limit of Rs. 2,00,000. Similarly, the limit of collateral based micro enterprise credit will be increased form Rs. 5,00,000 to Rs. 7,00,000.

c) A policy will be initiated to provide license immediately to financial services in backward regions, classes, gender and communities. In the context of growing challenges regarding regulation and supervision from the expansion of these institutions, second tier institutions (STI) will be established as a micro finance authority to regulate these institutions.

d) All necessary works will be put forward to establish micro-finance Development Fund which will replace RSRF established for providing credit to weaker groups in the society. Bank and financial institutions will be encouraged to establish a separate desk in order to monitor growth, access and effectiveness of credit to micro, small and medium scale industries. There has already been a separate department in the NRB for effective regulation and supervision of micro-finance institutions.

e) With a view to encourage deprived sector lending, the provision that does not require additional loan loss provision for the loans provided directly or also been continued this fiscal year for promoting deprived sector lending. Credit to housing, electricity; hospitals that fulfill the requirement of deprived sector credit will be reviewed and accordingly limit on such credit will be fixed.

f) In order to promote women empowerment through their increased participation in economic and professional activities, loan up to Rs. 400 thousands provided by bank and financial institutions for micro enterprises run by women will be counted in deprived sector credit. A refinance facility will provided for such loans by the NRB.

g) A provision will be introduced to include the credit up to Rs. 10 million provided by bank and financial institutions in hydropower project of up to 500kw capacity with at least 50 percent investment participation by community user committee or private sector into the deprived sector lending.

h) The ceiling of deprived sector loan provided against the guarantee of group member or person and classified as a pass loan for last two year has been increased to Rs. 100 thousands. Similarly the credit limit for micro-enterprises has been increased to Rs. 300 thousands. However, while lending such credit of up to Rs. 300 thousands.

i) Loans provided through consumer committee or cooperative for community irrigation in rural area and credit for buying tractor, thresher and other agricultural equipment's will be counted under the deprived sector credit.

j) Loans up to Rs. 300 thousands per household provided to establish cold storage in collective ownership for preserving food grains will be counted as deprived sector credit. Similarly, loans up to Rs. 400 thousands per household for animal husbandry, fishery, bee keeping and so forth will also be counted under the deprived sector credit.

k) Loans up to Rs 200 thousands provided by the banks and financial institutions without collateral to youths from deprived families for studying secondary and higher secondary level technical and vocational education will be counted as deprived sector credit.

l) In context of the large number of illiterate people residing in rural areas and having low financial literacy, necessary coordination will be made with GoN and other stakeholders to gradually include the content of financial literacy in informal education, vocational training and school level curriculum.

m) As per the provision of insuring deposits up to Rs. 200 thousand and small and medium size depositors for enhancing the public confidence towards BFIs, total deposits of Rs. 284.25 billion of 164BFIs have been guaranteed as of mid-June 2015. Total deposit amounting to Rs 252.76 billion was guaranteed in mid –July 2014. Similarly, under the credit guarantee provision, credit of Rs.1.05 billion has been guaranteed under the micro and deprived sector credit guarantee program and Rs. 168.4 million has been guaranteed for small and medium business in mid-june2015. In these sectors, Rs. 781 million and Rs. 99.5 million had been guaranteed in mid –June89 2014. In this regard, premium of Rs. 561.6 million has been collected from deposit guarantee and Rs. 2.95 million form credit guarantee.

A separate fund will be established to support financial access program in the rural areas form the amount collected through the penalty to the banks and financial institutions for not complying with deprived sector lending requirement.

4.5 Contemporary Issues and Challenges in Microfinance

Microfinance is now globally recognized as an effective tool for reducing poverty. It has shown positive results in many countries; however, microfinance services have not yet deepened down to rich the neediest poor. There are still huge masses of people deprived of financial services in Nepal as the number challenges facing the microfinance Industry in Nepal. They are discussed below:

1. **Outreach:** To include and serve rural and remote households living in hill and Tarai districts is a great challenge to us. Combined with providing comprehensive micro finance services (i.e. saving, credit, insurance, transfer and other support) is not sufficient as half fulfilled task. Quality and quality of service in a cost effective manner that sustain service providers and satisfy service receivers has been remained a tough task.

2. **Regulatory Issues**

   i) Weak follow up and monitoring: The FINGOs are registered as District Development Committee, District Administration Office are affiliated to social welfare council as patron organization to these institutions. But there is huge gap in terms of follow up, monitoring and sharing experiences for the growth of FINGOs.

ii) Lack of supporting program: Numbers of instances are experienced in microfinance sector which comes to the support from government that in the several pertinent issues such as to evaluate these financial institutions, facilitate for integration with development partners so as to create working environment and contribute more towards reducing poverty and empowering women communities. Even lack of supporting programme (such as insurance, incentives to work in rural and remote areas, etc.) from government side hinders the expansion with depth and breadth of microfinance service outreach in inaccessible parts of Nepal.

iii) Threats from volatile legal policy: The Financial Intermediary Act 2055 was enacted to pave way for creating and developing non-government organizations to serve rural and urban poor exclude by formal banks/finance companies. Pursuing the act of Nepal Rastra Bank that did take positive step to license some institutions as financial intermediary. After one decade, the environment of institutional growth has been restricted by the Central Bank that enforced to close the door of licensing new prominent NGOs to perform micro financing services and expanding the outreach of microfinance services. FINGO's practitioners feel that the legal environment is choking and unjustifiable contrary to the liberal environment given to commercial, development banks, and other institutions.

iv) Diversification of the fund: The licensing authorities seem does not much care about the shifting funds of deprived sector lending (DSL) from one account to another and treat it as the service microfinance. Similarly, many commercial and development banks also do not seem comfortable to this provision, and intend to build relation with local institutions. This lead to more dilemmas for the microfinance players who are working to this field.

3. **Unhealthy Competition:** Healthy competition is necessary for smooth and sound development of microfinance services. It is also felt that because of lack of supporting environment and less of coordination between government agencies and micro finance banks/institutions number of instances where duplications in the working areas of clients have been noticed. In limited areas where more institutions work with the same clients. Efforts still seem to be made from government/NRB side as well as close coordination between the players of this sector to avoid such unhealthy competition. Most of the wholesale lender also provides with credit

funds through the financial institutions that serve the same clients whereas clients who have dire need of microfinance support in the rural areas are still not in the reach of these microfinance banks and institutions. Government and central banks will privatize RSRF (develop as National Micro-finance Development fund/ or merge with appropriate apex i.e. Rural Micro Finance Development Centre and PAF etc.). Creation of parallel institutions having the same purposes may create unhealthy competitions and develop in-efficiency.

4. **Resources Constraints:** Out of three percent of deprived sector credit funds which comes to around NRs. 20,791 billion, NRs. 6,500 billion was allocated to youth employment program has led to make the another limitation to working for MFIs. It is felt that youth employment scheme is essential, but it needs fund from different windows rather than the same RSRF with the main concern of not making any distortion in the microfinance sector. One of the concerns is observed that commercial/development banks seem investing in import-based consumer goods. This should be regulated by government/NRB authority. Such practice never allows rural economy to receive fund for mobilizing local resources and create self-employment opportunities at local levels. Due to change in cost of raw materials and labor, need of micro credit in this sector is insufficient. At present institutions are getting funds of short term nature from banks. To finance medium term enterprises like low cost housing, alternative energy equipment and cottage industries, credit fund of larger loan for scale up and comparatively higher investment is necessary.
5. **Higher Operating Cost:** Most MFIs do not feel comfortable to launch services to the deprived group of the far flung areas in the country. As a result, the poorest of the poor and the vulnerable groups of the hills and mountains have not been benefited from the services of MFIs. MFIs think that they cannot penetrate the remote areas due to higher costs involved in loan administration. They have the prejudice that they cannot operate in remote areas, without subsidy or grant support for operating cost from the government or donors until they attain operational self-sufficiency.
6. **Lack of Infrastructure and Market:** Lack of products and very limited economic activities due to low density of population have posed problem to the financial institutions to expand their operations in the remote, hills and mountains. Likewise, low level use of suitable agriculture technology is another problem in promoting

microfinance in the geographically remote areas. Lack of alternatives to subsistence farming is also hindering microfinance service in these areas. Moreover, market for the agricultural products is constrained due to high transportation cost.

7. **Lack of Professionals:** There is lack of professionalism among some of the MFIs. They lack a matching pool of knowledge and skills required for running MFIs program as a business. They see microfinance as social program that are bound to incur losses and need to be subsidized by the government or donors. They often charge very low rate of interest on their loans that cause them loss. Most MFIs do not have business plans and lack strategies to achieve sustainability in their operations. Further, there is also a serious shortage of institutions that can provide capacity building to the MFIs. Hence, developing professionally managed capable MFIs is also a challenge to this sector.
8. **Impacts of Overlapping of Clients:** As a result of competition among MFIs, there are high chances of overlapping. Same client could be a member of more than one MFI. Some subtle and clever borrowers may repay loans of one MFI out of the loans taken from the another MFI to maintain timely repayment and finally the borrower may be over indebted and go out of capacity to repay outstanding loans in the two or more institutions. This will contribute negatively to both MFIs on meeting their objectives of poverty reduction and that of clients in encouraging misuse of funds. This will not only deprived the chances of ultra-poor I getting microfinance services but will also develop sour relation between the MFIs involved in duplication.
9. **Management Challenges:** There are some critical managerial challenges that MFIs are facing to the areas as highlighted here under:

i) Resources and fund management at local branch unity is risky (because of the lack of insurance and security measures).

ii) Efficient and trained staff is deficient.

iii) Lack of committed staff/ personnel to work in remote ad rural areas

iv) Lack of institutions doing monitoring and supervision of financial institutions and guide them for appropriate linkages and support.

v) Lack of support for the second tier organization like MIFAN, which can play a greater role for monitoring and supervision of the financial institutions.

vi) Trade unions are being formed in institutions demanding equal facilities at par with government and banks. To cope up with such issues, financial institutions and regulatory bodies should work together.

4.6: Pattern of Deprived Sector Lending of Prabhu Bank Limited

The deprived sector lending along with direct and indirect lending is given in the following table:

Table 4.4: Pattern of Deprived Sector Lending of Prabhu Bank Limited

(Rs. in million)

Year	Deprived Sector Lending	Direct Lending	Indirect Lending	Yuwa Sworojgar Loan
2009/10	0.69	0.69	0	0
2010/11	59.30	8.40	316.0	34.90
2011/12	401.15	13.52	352.71	34.91
2012/13	493.50	160.90	297.70	34.90
2013/14	716.62	167.94	513.78	34.91
2014/15	725.02	114.83	575.27	34.91
2015/16	1214.07	175.05	1002.59	36.42

Source: Nepal Rastra Bank, 2016 and Appendix-I

The table 4.4 shows the deprived sector lending along with direct and indirect lending of Prabhu Bank is increasing trend from 2009/10 to 20015/16. The deprived sector lending consists of direct lending, indirect lending and Yuwa Sworojgar Loan. Among the deprived sector lending, the indirect lending has higher than direct lending and Yuwa Sworojgar Loan. The direct lending includes agriculture, domestic industries, services and others. Likewise indirect consists of institutional lending (wholesale) and share investment. The Yuwa Sworojgar Loan included retail loan given to single person for small amount business loan and foreign employment loan. Among the directed loan large amount is given in agriculture sector. Similarly among indirect loan large portion of loan is given in institutional lending (wholesale). In 2009/10 the deprived sector lending is Rs. 0.69 million in Prabhu Bank and it reached Rs. 1214.07 million in 2015/16. Similarly in 2009/10 the directed lending is Rs. 0.69

million and it reached 175.05 million in 2015/16. But Yuwa Sworojgar Loan was 0 in 209/10 and it reached to 36.42 million in 2015/16.

4.7 Trend of Deprived Sector Lending of Prabhu Bank Limited

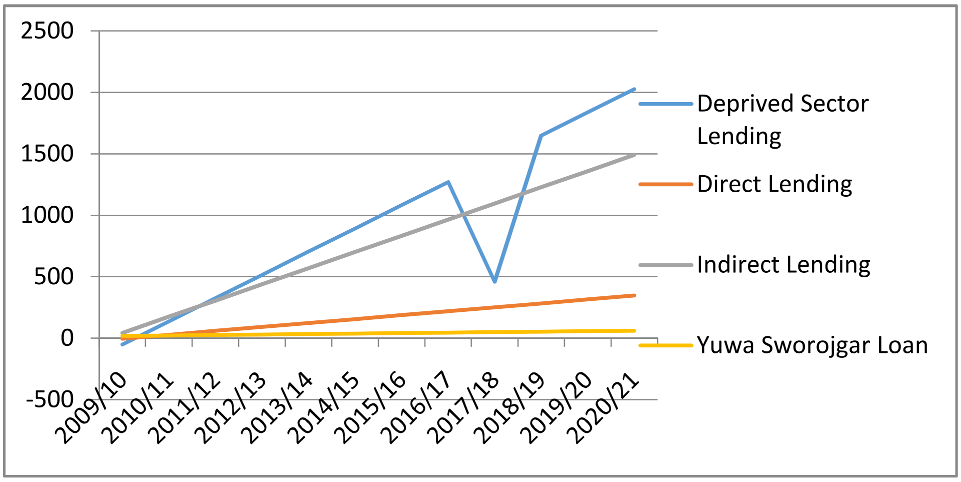
The trend analysis of Prabhu Bank Ltd. enables to compare two or more time series over different periods of time and draw important conclusions about them. If the values of phenomenon are observed at different periods of time, the values so obtained would show considerable verities or changes. Among various devices for measuring changes in financial statement of the firm, trend analysis is the effective tools, which minimize the weakness of the ratio analysis to some extent.

Table 4.5: Trend Value of Deprived Sector Loan, Direct Lending, Indirect Lending and Yuwa Sworojgar Loan of Prabhu Bank Limited (Trend value)

Year	Deprived Sector Lending	Direct Lending	Indirect Lending	Yuwa Sworojgar Loan
2009/10	-50.7	-3.97	41.79	18.43
2010/11	138.12	28.01	173.48	22.33
2011/12	326.94	59.81	305.17	26.23
2012/13	515.76	91.61	568.55	30.13
2013/14	704.58	132.41	700.24	34.03
2014/15	893.4	155.21	831.93	37.93
2015/16	1082.22	187.01	963.62	41.83
2016/17	1271.04	218.81	1095.31	45.73
2017/18	1459.86	250.61	1227	49.63
2018/19	1648.68	282.41	1358.69	53.53
2019/20	1837.5	314.21	1490.38	57.43
2020/21	2026.32	346.01	3906.11	61.33

Source: Appendix-I

Figure 4.1: Trend Value of Deprived Sector Loan, Direct Lending, Indirect Lending and Yuwa Sworojgar Loan of Prabhu Bank Limited



Source: Table 4.5

In case of the trend of direct lending of Prabhu Bank Limited, it is in increasing trend till 2015/16. Higher the direct lending less will be the profit of financial institution. The average direct lending of Prabhu Bank is NRs. 91.61 million, which is increasing at the rate of NRs. 31.80 million per year. Directed loan are expected to decrease from NRs. 3.97 million in 2009/10to increased 346.0.1 million in 2020/21. Figure 4.1 represents the trend line of total deprived sector loan, direct lending, indirect lending and Yuwa Sworojgar Loan of Prabhu Bank Limited for seven consecutive years.

4.8 Major problems of Deprived Sector Lending

i). Insecurity: Clients of Deprived Sector Lending got loan from MFIs branch and banks not from their community. MFIs and bank have made policy of disbursing loan from MFIs and bank branch office due to insecurity of money. At initial period, MFIs and bank were disbursed loan and collected installment from community, but now all MFIs and bank are disbursing and collection installment in concerned branch to reduce robbery of the money. The branches were in local level before conflict period in the country, but financial institutions removed the branch from rural areas and amalgamated with other branch, clients want the branch in their local areas.

ii). Short Period Installment: MFIs clients have to repay the loan in fixed duration of installment. Some have 7 days, some have 15 days and some have monthly installments. Due to short duration of installment, MFIs clients felt difficulties to repay, and if they could repay also, they cannot able to earn, people who invest the loan in long period activities (like, animal husbandry, agriculture) couldn't earn in short period. Deprived Sector Lending have to repay in 7 days installments, though it was small amount, people who invest the loan in small business only can repaid easily, other couldn't repaid by the earning of loan. It is one of the problems felt by microfinance clients.

iii). Conflict situation: Due to the political conflict raised in the country, MF program also affected. CRRDB has stopped the program due to conflict situation. Other MFIs has also faced the problem of political conflict. Though the APF base camp and Area Police Office lies in different rural areas, Microfinance staff are facing the problem of insecurity. Sometime collected money rubbed by underground group (rubbers) and they frequent have to face threatens of underground group for donation.

iv). Duplication of Programs: Duplication of the program is another problem of Deprived Sector Lending. In local areas, more than one MFIs and banks are working and covering same clients. Due to lack of coordination between MFIs, some clients benefited by several MFIs, instead of including the excluded area and poor people. There are still large numbers of interested client's remains to cover in MF program.

V). Misuse of Loan: Although Deprived Sector Lending has various advantages for poor people, but sometimes, loan might be misused. MFIs and bank provide loan for poor people in the name of woman to reduce the informal moneylenders, but due to lack of monitoring and insincerity of members, third person are using the loan. Third person (who is not member of microfinance) collect the loan from more than 1 people and invests own, that why actual members couldn't benefited from the loan and make income. People should aware and MFIs and bank should tight in such case. Otherwise, again money lenders and local merchants can use the poor people as per their benefits.

4.9 Contribution on Deprived Sector Lending of Prabhu Bank Ltd.

In context of Nepalese economy there are too many Banking and financial institutions are providing services from the different parts of country. Although the deprived sectors peoples cannot enjoy form these services of banking and financial institutions due to lack of their income source and collateral status. For the deprived sector mainly Micro finance companies are only working by charging highly interest from them. But current scenario is different from past years due to strictly monitoring of Nepal Rastra Bank. Now all of the banking and financial institutional have force full lending to the deprived sector which have mention by Nepal Rastra Bank. In this condition Commercial Banks have to make 5 % lending of their total portfolio of deposit. In this regards, Prabhu Bank Ltd. which is one of the fastest grown Commercial Bank in Nepalese market has also invest as Micro wholesale lending and direct lending to the deprived peoples of different location of Nepal. In Micro wholesale lending Prabhu Bank has invest through different micro finance companies like Swabalamban Laghu Bitta Bikas Bank, Nirdhan Laghu Bitta, Forward Micro finance, First Micro Finance like many more and In retail lending Prabhu Bank has invest in different heading like, agriculture loan, home loan, auto loan, over draft loan, micro finance over draft loan, term loan, hire purchase loan and yuwa sorojgar loan etc. from where many of the peoples generate level of income including their small business, small cottage industries, Hotels & Restaurants and some of them are working in middle east countries with the help of Baideshik Rojgar karja which is provided by Prabhu Bank Ltd. according to Banking Supervision report 2016, total 6 months prior loan of commercial banks had Rs. 815480.06 million, where Prabhu Bank Ltd. had Rs. 31264.72 million among the total commercial bank.

CHAPTER - V

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of Findings

From the review of regulations, best practices from available literature and findings from various research conducted in this territory, it was found that present regulation from micro finance, development banks and commercials banks are considered as mostly conductive for their functioning and growth. The announcement of deprived sector lending policy has been playing very important role in the expansion of micro financing. It is globally accepted that micro finance cervices 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 sources of financial resources of the country. Due to the various reasons, these institutions are voluntarily unwilling to involve in small and rural financing. In order to provide certain portion of their resources in the rural financing NRB has 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.

Product and service delivery methodologies, limited physical infrastructure, and scattered settlements have compelled these implementing agencies to confines their operation to the tarai and accessible hill district. There is also a need to invest in innovative product and service delivery methodologies, and to basic physical infrastructure to expand the frontier of micro finance services to previously in accessible hill and mountain areas. The use of modern technology in the Nepalese microfinance industry is at an early stage. There is a need for using modern technology to enhance the efficiency of microfinance operations. Consistent with the expansion of telecommunication facilities, the possibility of introducing such technologies in Nepal's microfinance sector should be extensively explored.

The study found that the deprived sector lending along with direct and indirect lending of Prabhu Bank Limited is increasing trend form 2009/10 to 2015/16. The deprived sector lending consists of direct lending, indirect lending and Yuwa Sworojgar loan. Among the deprived sector lending the indirect lending has higher than direct lending and Yuwa Sworojgar loan. The direct lending included agriculture, domestic industries, services and others. Likewise indirect lending consists of institutional lending (wholesale) and share investment. The Yuwa Sworojgar loan included retail loan given to single person for small amount business loan and foreign employment loan. Among the directed loan large amount is given in agriculture sector. Similarly among indirect loan large portion of loan is given in institutional lending (wholesale). In2009/10 the deprived sector lending is Rs. 0.69 million of Prabhu Bank Ltd. and is reached Rs.1214.07 million in 2015/16. Similarly in 2009/10 the directed lending is Rs. 0.69 million and it reached Rs. 175.05 million in 2015/16. But Yuwa Sworojgar Loan was 0 in 2009/10 and it reached Rs. 36.42 million in 2015/16 of Prabhu Bank.

The average total deprived sector loan of Prabhu Bank Limited is NRs. 515.76 million, which is increasing at the rate of NRs. 188.82 per year. Total deprived sector loans are expected to increase from NRs. 50.7 million in 2009/10 to 2026.32 million in 2020/21. As Prabhu Bank is suffering more from the problems of bad debt, they seem to be concentrated more on recovery rather than lending.

Similarly, if we look at the trend of direct lending of Prabhu Bank Limited, it is in increasing trend till 2015/16. Higher the direct lending less will be the profit of financial institution. The average direct lending of Prabhu Bank is NRs. 91.16 million which is increasing at the rate of NRs. 31.80 million per year. Direct loans are expected to decrease from NRs. 3.79 million in 2009/10 to 346.01 million 2015/16. Figure 4.1 represent the trend of line of total deprived sector loan, direct lending, indirect lending and Yuwa Sworojgar Loan of Prabhu bank Limited for seven consecutive years.

5.2 Conclusion

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 tarai, 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. Access to financial services in Nepal is largely concentrated in the tarai and accessible hill districts with virtually no services available in inaccessible hills and mountain areas. Where Prabhu Bank has provide the deprived sector loan in different head from different branches across the country. Direct loan Like Baideshik Rojgar, Auto (City Riksha) Loan, agriculture loan, Hire Purchase Loan, Term Loan, Home Loan, Low Cost Housing Loan etc. and as well as Microfinance Wholesale loan to different micro finances companies. Through these types of lending on different areas they have got economic support to enhance their economic level as well living standard.

In RMDC's partner implementing agencies and their operations are not an exception. Product and services delivery methodologies, limited physical infrastructure, and scattered settlements have compelled these implementing agencies to confine their operations to the Tarai and accessible hill districts. There is also a need to invest in innovative product and service delivery methodologies, and to improve basic physical infrastructure to expand the frontier of micro finance services to previously in accessible hill and mountain areas. Despite various efforts on strengthening institutional credit to the rural people it is interesting to know that majority of the rural households have thinner access to formal financial institutions. On top of that, the supply side analysis of rural finance in Nepal has indicated that there is a wide gap between demand for and supply of credit. Nepal Rastra Bank as a central bank of the country is considered as one of the highly supportive Central Bank of the region in micro finance and poverty reduction approaches. This does not mean that there is no scope for improving the legal, policy and regulatory environment. Nepal Rastra Bank initiative on developing a National Policy Framework, creation of STI for management of Microfinance Development Fund regulation and supervision is hanging on since last 3 years. The long debate going on suggests that unanimous implementable mechanism has not been worked out till recent days. Aftermath of the success of 2^{nd} democratic movement the country is in transition. The future of this country lies in the inclusiveness in all walks of life i.e. social, economic, political and psychological. Therefore the challenge for Nepal Rastra Bank at present is to redraft these policies, lows and regulations with futuristic outlook of inclusiveness, growth and equitable sharing. Policy orientation needs to be geared towards loosening control from public domain to private initiatives. The role of government and central bank should be recasted as facilitator providing legal and regulatory framework for the promotion of private initiatives. The traditional role of acting as guardian should be converted into a supportive and friendly one.

5.3 Recommendations

On the basis of study, various recommendations are given for stakeholders, government, central bank, apex funds (wholesale lending microfinance institutions, program), micro finance institutions themselves etc. in order to lessen the problems and overcome the challenges, the makes the following recommendations for the consideration of the policy makers, the practitioners and the other stake holders.

i) The policy for "micro finance" needs to be developed in order to promote private sector institutions and investment, which is instrumental in reaching out to large number of clients. The direct involvement of government and restricted regulatory control of central banks should be minimized.

ii) The role of Government and NRB could focus on research (such as impact assessment), capacity building (creating training institute-provide support on generating funds required), recognizing and rewarding beat practices (awards and prizes etc.). Republic of the Philippines National Strategy for micro finance provides an exemplary overview of an acceptable to all stakeholders policy framework.

iii) For reaching of the poorest of the poor, it is necessary to expand services to far flung remote areas and deepen the services down to them. The fund cost in Nepal is cheapest in Asia, which is only 5-6% as compared to India and Bangladesh where the fund cost of MFI is around 11%. MFIs in Nepal with this margin can still have some profit in providing microfinance services to the poor. MFIs specially the larger one who have attained OSS should change their mindset and gear up their programs towards far flung remote districts. However, they have to devise low cost model such as using mobile team to disburse and collect loans, monthly repayments etc. MFIs need to go to the deprived areas as their potential market and take necessary steps to design models suitable to address the needs of the people therein and reduce cost of operation to the possible extent and realize profit within a certain timeframe.

iv) It is also essential to maintain peace and security in the country in order to provide security to MFIs, which would be stationed at remote locations for providing microfinance services to the poor.

v) The STIs shall prepare self-regulatory framework, performance standards, rating tools, benchmarks and financial ratios to be monitored in consultation with related stakeholders. Proposed STIs will have responsibility of supervising and inspecting (off-site and on-site) FINGOs and taking supervisory actions are delegated by central bank. It should act on behalf of central bank but with enough autonomy. It should submit its detailed annual inspection and supervision report to Nepal Rastra Bank and department of cooperatives and also work with close cooperation. Nepal Rastra Bank/ department of cooperatives on the other hand must supervise them in a given interval of performance indicators.

vi) Participation in policy formulation: All stakeholders voice to be heard, through a mechanism on policy formulation. Micro finance summit, Nepal could be a forum to this end.

vii) Hill/Urban model: Government, donors, NRB and MF practitioners need to address hill/urban poverty which seems to be increasing in a faster rate.

viii) Capacity building of multipurpose cooperatives and SACCOS should be considered as strategy to enhance rural finance.

ix) SACCOS should be allow to promote BFI or by BFI equity share.

x) Development of Microfinance Rating tools and implanting for the verities of purposes including financing them.

xi) Develop micro-insurance policy and schemes to promote micro-finance outreach.

xii) The risk fund and insurance fund necessary to cover natural and physical hazards faced by clients and financial institutions. Some funds for developing infrastructure (software, training to staff) of the institutions that serve in hill and rural areas are necessary.

xiii) Clarify the donor’s role-Donors need to develop their DO’s and DON’Ts and develop consensus guideline in line to CGAP international guideline. It is suggested that they involved in MF through partner organization and not directly. They could contribute to MF development fund, support capacity building of MFIs, support MIS system, visits, training, and networking effort through POs.

xiv) Based on principles, best practices and above-mentioned background, it is recommended to incorporate following issues in the future policy documents as follows:

i) There will be no direct participation by government and central bank from now on by way of implementing micro-finance program, creating new micro-finance institutions**.**

ii) Existing micro-finance institutions/program will be handed out to private sector in a phase out manner.

iii) There will be no ceiling and pulling down of interest rate for micro-finance institutions.

iv) Government and central bank will help micro finance institutions in capacity building and institutional development by way of appropriate growth oriented regulatory provision and supporting (financial and other) to the extent possible. Government may provide land and physical facility to create a national level micro-finance research and training institution to be run on.

v) Government and central bank may provide financial support for such committee activities to be managed by private institution of reputation such as Center for Micro-Finance (CMF).

vi) Government shall provide tax incentives to people/firm/companies/corporate bodies if they provide fund to micro-finance institutions.

vii) Government and central bank will arranging a visit program annually to various micro-finance practitioners within Nepal and some foreign countries to observe best practices in micro finance and provide some number of financial support (with a transparent policy) for attending boulder “micro finance training” attending “micro credit summit” and events supposedly to create positive impact in domestic growth of micro-finance sectors.

viii) Government and central bank shall conduct impact assessment of micro-finance services on poverty reduction and macro-economy in a given interval.

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APPENDICES

i). Calculation of Trend values of Deprived Sector Lending of Prabhu Bank Limited.

Year	Deprived Sector Lending (Y)	Deviation from Mid July 2012/13 (X)	X^2	XY	Y= a-bx
2009/10	0.69	-3	9	-2.07	-50.7
2010/11	59.30	-2	4	-118.6	138.12
2011/12	401.15	-1	1	-401.15	326.94
2012/13	493.50	0	0	0	515.76
2013/14	716.62	1	1	716.62	704.58
2014/15	725.02	2	4	1450.04	893.4
2015/16	1214.04	3	9	3642.21	1082.22
N=7	∑Y=3610.35	∑X=0	$\sum X^2$=28	∑XY- =5287.05	

Here,

When ∑X =0 from two normal equations,

a=∑Y/N = 3610.35/7 = 1691.17

b=∑XY/$\sum X^2$ = 188.02

Hence, the equation of straight line trend is

Y = a+bx

Expected Trend Values of Deprived Sector Lending

Year	Deviation from Mid July 2012/13 (X)	Y= a+bx
2016/17	4	1271.04
2017/18	5	1459.86
2018/19	6	1648.68
2019/20	7	1837.5
2020/21	8	2026.32

ii). Calculation of Trend values of Direct Sector Lending of Prabhu Bank Limited.

Year	Deprived Sector Lending (Y)	Deviation from Mid July 2012/13 (X)	X^2	XY	Y= a-bx
2009/10	0.69	-3	9	-2.07	-3.79
2010/11	8.40	-2	4	-16.8	28.01
2011/12	13.52	-1	1	-13.52	95.81
2012/13	160.90	0	0	0	91.61
2013/14	167.94	1	1	167.94	123.41
2014/15	114.83	2	4	229.66	155.21
2015/16	175.05	3	9	525.15	187.01
N=7	∑Y=641.33	∑X=0	$\sum X^2$=28	∑XY- =890.36	

Here,

When ∑X =0 from two normal equations,

a=∑Y/N = 641.33/7 = 91.61

b=∑XY/$\sum X^2$ = 31.80

Hence, the equation of straight line trend is

Y = a+bx

Expected Trend Values of Deprived Sector Lending.

Year	Deviation from Mid July 2012/13 (X)	Y= a+bx
2016/17	4	218.04
2017/18	5	250.61
2018/19	6	282.41
2019/20	7	314.21
2020/21	8	246.01

iii). Calculation of Trend values of Indirect Sector Lending of Prabhu Bank Limited.

Year	Deprived Sector Lending (Y)	Deviation from Mid July 2012/13 (X)	X^2	XY	Y= a-bx
2009/10	0	-3	9	0	41.79
2010/11	316.0	-2	4	-632	173.48
2011/12	352.71	-1	1	-352.71	305.17
2012/13	297.70	0	0	0	436.86
2013/14	513.78	1	1	513.78	568.55
2014/15	575.27	2	4	1150.54	700.24
2015/16	1002.59	3	9	3007.77	831.93
N=7	$\sum Y=3058.05$	$\sum X=0$	$\sum X^2=28$	$\sum XY=3687.38$	

Here,

When $\sum X=0$ from two normal equations,

$a=\sum Y/N = 3058.05/7 = 436.86$

$b=\sum XY/\sum X^2 = 131.69$

Hence, the equation of straight line trend is

Y = a+bx

Expected Trend Values of Deprived Sector Lending

Year	Deviation from Mid July 2012/13 (X)	Y= a+bx
2016/17	4	963.62
2017/18	5	1095.31
2018/19	6	1227
2019/20	7	1358.69
2020/21	8	1490.38

iv). Calculation of Trend values of Yuwa Sworojgar Loan of Prabhu Bank Limited.

Year	Deprived Sector Lending (Y)	Deviation from Mid July 2012/13 (X)	X^2	XY	Y= a-bx
2009/10	0	-3	9	-2.07	18.43
2010/11	34.90	-2	4	-16.8	22.33
2011/12	34.91	-1	1	-13.52	26.23
2012/13	34.90	0	0	0	30.13
2013/14	34.91	1	1	167.94	34.04
2014/15	34.91	2	4	229.66	37.93
2015/16	36.42	3	9	525.15	41.83
N=7	∑Y=210.95	∑X=0	$\sum X^2=28$	∑XY- =109.28	

Here,

When ∑X =0 from two normal equations,

$a=\sum Y/N = 210.95/7 = 30.13$

$b=\sum XY/\sum X^2 = 3.90$

Hence, the equation of straight line trend is

Y = a+bx

Expected Trend Values of Deprived Sector Lending

Year	Deviation from Mid July 2012/13 (X)	Y= a+bx
2016/17	4	45.73
2017/18	5	49.63
2018/19	6	53.53
2019/20	7	57.43
2020/21	8	61.33