Financial Inclusion in Nepal: Progress and Constraints

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Abstract

Financial inclusion is essential for building an inclusive financial system which is supposed to be helpful for reducing poverty and inequality in the economy. This paper aims to analyze the progress of financial inclusion in Nepal over time. With various efforts taken in the past, financial inclusion in Nepal has been progressing. Yet, Nepal has inadequate and unequal access as well as very low usage, particularly use of credit and digital medium, indicating a long way ahead to make financial system more inclusive. There are several bottlenecks for expanding financial inclusion such as difficult geography, scatter settlement in villages, illiteracy and high digital knowledge gap in Nepal. By utilizing modern technology and adopting as well as implementing inclusive policies, access to finance has to be increased inclusively. Further, by creating financial awareness and increasing the benefits, the usage of formal financial services should be increased for meaningful financial inclusion. Foreign direct investment and transfer of technology in the areas of FinTech can also expand financial inclusion in Nepal in a profitable way.

*JEL Classification*: G21, G28, O16

*Keywords*: financial inclusion, progress, constraints, financial institutions, Nepal
1. Introduction

Financial inclusion is essential for building inclusive financial system as well as overall inclusive economy, helpful for reducing poverty and inequality in the economy. Efficient and well-functioning financial systems are very essential to channelize funds to the most productive usages and manage risks; thereby promoting economic growth (Demirgüç-Kunt et al., 2008). Hence, access to finance should be improved and financial system in an economy must be inclusive. Because of its importance, financial inclusion has drawn a lot of attention of academicians and policy makers all over the world in recent years (Sarma, 2010; World Bank, 2014).

Financial development is not just enough and inclusive if a large section of population is excluded. All people need to have access to financial service at an affordable cost for the financial system to be inclusive. Financial services are required for conducting economic activities and for financial management in the modern market economy. Without financial inclusion, "poor individuals and small enterprises need to rely on their personal wealth or internal resources to invest in their education, become entrepreneurs, or take advantages of promising growth opportunities" (Demirgüç-Kunt et al., 2008, p. 22) which is not normally possible when they are in a poverty trap. Hence, financial inclusion can serve as a means to bring them out of poverty. However, in many countries not all people have been included in the financial system, and so is the situation in Nepal as well, demanding concrete efforts for it.

Financial inclusion is also needed to achieve the Sustainable Development Goals (SDG). The SDGs envision that economic development should not leave anybody behind. Financial inclusion is not only necessary to provide access to financial service to those at the bottom of income pyramid and vulnerable people, but also empower them to be economically strong by preventing them from exploitative informal finance. Inclusive financial system, in fact, ensures the availability of at least basic financial services like saving, credit, payment and insurance to all people irrespective of income and space at a reasonable cost. "Access to financial services has a critical role in reducing extreme poverty, boosting shared prosperity, and supporting inclusive and sustainable development" (World Bank, 2014, p. 1). Hence, making inclusive financial system is necessary for achieving several of SDGs within reach (UNESCAP, 2019).

International organizations like World Bank, International Monetary Fund (IMF), Asian Development Bank (ADB) and Alliance for Financial Inclusion (AFI) have placed financial inclusion as an important agenda in recent years and have started monitoring the progress of financial inclusion along with providing policy suggestions and financial assistance. The IMF has recently initiated “Financial Access Survey” in an endeavour to put together cross-country data and information relating to the issue of financial inclusion, while the World Bank has been publishing Global Findex Database every three years since 2011.

Nepal has also given importance to financial inclusion by adopting various policy measures. As a result, access to finance and financial inclusion have been improving. It is necessary to review and assess the situation of financial inclusion time to time to design right policy measures for making financial system inclusive. There is a growing body of literature on financial inclusion in the world such as Demirgüç-Kunt et al. (2008), World Bank (2014), Mehrotra and Yetman (2015), Sahay et.al. (2015), and Tissot and Gadanecz (2017). However, a few studies such as Dhungana and Kumar (2015), Pant (2016) and Shrestha (2020) demonstrate the status of financial inclusion in Nepal to some extent.

In this context, this paper presents the progress, highlights efforts and explores existing problems and constraints for financial inclusion in Nepal. This assessment will be useful to
know the progress to design and expedite the implementation of measures for financial inclusion. However, the limitation of the paper is that it has ignored the analysis of development in insurance services and access to finance available to firms.

The paper has used secondary data published by Nepal Rastra Bank (NRB) and the World Bank. In addition to publication of supply-side data by NRB, World Bank's Global Findex database developed by Demirgüç-Kunt et al. (2018) have been used to make comparative analysis in different periods of time. Since financial inclusion has both supply and demand sides, findings of two demand side surveys conducted by Ferrari (2007) and UNCDF (2016) are also used here. Progress after 2014 when demand-side survey was carried out has been given more focus in this analysis.

Structure of this paper is as follow. Section 2 presents the multiple aspects of financial inclusion covering various aspects of it followed by efforts done for financial inclusion in Nepal in Section (3). Section (4) presents the progress in making financial system inclusive in Nepal. Section (5) reviews the constraints faced by Nepal for financial inclusion. Section (6) ends the paper with conclusions and some policy recommendations.

2. Multiple Aspects of Financial Inclusion

2.1 Concept

Financial inclusion and access to finance are sometimes used interchangeably, but the former is broader than the latter by including uses. Financial inclusion aims to provide access to finance to all and increase usage, especially focusing those people who are normally excluded by existing formal financial system considering them unbankable. Access to finance commonly refers to the availability of quality financial services at a reasonable cost. Simply, financial inclusion refers to the situation that nobody is in state of financial exclusion. Leyshon and Thrift (1995) and Conroy (2005) define financial exclusion as referring to those processes that serve to prevent certain social groups and individuals, mostly poor and disadvantaged social groups, from gaining access to the formal financial system. Financial exclusion signifies the lack of access by certain segments of the society to appropriate, low-cost, fair and safe financial products and services from mainstream providers (Mohan, 2006).

On the other hand, financial inclusion is defined as the process of ensuring access to financial services timely and adequate credit where needed by vulnerable groups such as the weaker sections and low income groups at an affordable cost (Rangarajan Committee, 2008, p. 1). However, in many developing countries, not so poor are also excluded from financial services. More broadly, hence "financial inclusion implies an absence of price and non-price barriers in the use of financial services" (Demirgüç-Kunt et al., 2008, p. 22). According to BIS (2015), financial inclusion covers three dimensions: accessibility, usage and quality of financial services to all kind of people. World Bank (2014) defines financial inclusion as the proportion of individuals and firms that use financial services, and argues that "financial inclusion does not mean finance for all at all costs since some individuals and firms have no material demand or business need for financial services"(p. 3).

2.2 Role

A number of benefits can be derived by enhancing financial inclusion including improvement in the lives of the people and expansion in domestic economic activities (Pant, 2016). Although access to finance is necessary for all members of society, it is particularly more important for disadvantaged and low income segments of society, as it provides them opportunities to save and invest, and protect themselves from various risks such as natural disasters, illness, and loss of livelihoods. Access to finance will enable the poor and low income people to make economic self-realization and give chances to break the vicious cycle of
poverty by encouraging them to engage in income generating activities. Normally, these poor people lack collateral, credit history and connection that formal financial system generally looks at while providing credit, which needs to be tackled by financial inclusion process and policy.

Access to finance, whether through mainstream financial institutions or through microfinance and other specialized institutions, can expand the opportunities for poorer households to engage in productive activities and enhance their capabilities. It confers substantial welfare gains for poorer households by, for example, allowing them to smooth their lifetime consumption and coping with negative shocks. Broadly, access to finance can in fact contribute to broaden economic growth as well as broader social development. Not having to depend on cash, but utilizing safer, less costly, and faster modes of transferring payments allows more economic transactions across greater geographic distances (Pant, 2016). Financial inclusion, in fact, creates positive externalities by increasing positive incentives through reducing financial market friction and providing opportunities (Demirgüç-Kunt et al., 2008).

Moreover, Sahay et al. (2015) showed that household’s access to finance has a strong positive relationship with economic growth. Greater financial inclusion may also lead to an improvement in the effectiveness of both monetary and fiscal policy (Khan, 2012). Fiscal effectiveness is enhanced both through rising the tax base and through greater effectiveness of welfare benefit and transfer schemes, which can be facilitated by the availability and use of financial services. The greater inclusion of people in formal financial services also bolsters the impact of monetary policy decisions on the real side of the economy, enhancing prospects of non-inflationary growth (Pant, 2016). Increased financial inclusion alters the behaviour of firms and consumers, subsequently influencing the efficacy of monetary policy (Mehrotra and Yetman, 2015). Financial inclusion strengthens monetary policy especially by enhancing the role of interest rate as a primary tool in the economy (UNESCAP, 2019).

2.3 Types of Financial Exclusion

There could be five types of financial exclusion as discussed in various studies which are shown in Table 1 (Sarma, 2010). Hence, ensuring financial inclusion is a multidimensional issue, demanding multiple approaches for increasing it. Access exclusion normally happens due to geographical difficulties and scattered settlement, normally found in the developing countries like Nepal. Even when there is physical access to finance, financial exclusion can happen due to other factors such as inappropriate conditions, non-affordability of financial services, targeted marketing and sales of financial products and self-exclusion due to fear of refusal or psychological barriers.

Table 1
Types of Financial Exclusion

<table>
<thead>
<tr>
<th>S.N.</th>
<th>Types of Financial Exclusion</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>access exclusion</td>
<td>due to geography</td>
</tr>
<tr>
<td>2</td>
<td>condition exclusion</td>
<td>due to inappropriate conditions for some people</td>
</tr>
<tr>
<td>3</td>
<td>price exclusion</td>
<td>due to non-affordability of financial services</td>
</tr>
<tr>
<td>4</td>
<td>marketing exclusion</td>
<td>due to targeted marketing and sales of financial products</td>
</tr>
<tr>
<td>5</td>
<td>self-exclusion</td>
<td>due to fear of refusal or psychological barriers</td>
</tr>
</tbody>
</table>

Note. Sarma (2010)
Financial exclusion can be further categorized as: voluntary and involuntary as shown in Figure 1. Non-users of formal financial services may have access but they choose not to use financial services due to various reasons. Voluntary exclusion may occur when individuals feel no need to use financial service or prefer to use cash in economic transactions. Some people may use the financial services indirectly, normally through other members of family by excluding oneself.

Several factors may result in involuntary exclusion in using financial services, which is more important to focus on. As shown in Figure 1, these factors include insufficient income /high risk, not fulfilling documentation requirement, high prices of financial services, lack of knowledge of financial products and rules, and unsuitable products. "High fees, high minimum balances, and strict documentation requirements can make financial products unaffordable for a large section of the population, while less convenient service delivery mechanisms and long loan application waiting times may lead potential clients to seek alternative financial service providers" (Barr et al., 2007, p. 15).

The main policy arena will be on involuntary exclusion, those individuals and firms that would like to use financial services but cannot. Policymakers and authorities should focus on reducing involuntary exclusion on financial services. Involuntary exclusion could be reduced through enhancing physical access, making financial services affordable and simplifying the eligibility criteria.

**Figure 1**

*Voluntary and Involuntary Financial Exclusion*

![Financial Exclusion Diagram](Diagram)

*Note.* Modified based on Demirgüç-Kunt, et al. (2008)
2.4 Measuring Financial Inclusion

Measuring financial access as well as inclusion is not straightforward. Widely used aggregate financial development indicators such as the ratio of bank credit to GDP and M2/GDP can hide substantial disparities across the population of individuals and firms in the economy. These indicators do not show inclusiveness nature of finance. Hence, we need separate financial inclusion indicators to ensure no one is left behind on getting financial services.

Financial inclusiveness whether for households or for firms ultimately depends on both demand and supply side situations. Provider (or supply side) data can be found in regulatory agency or financial institutions publications. These include the number of accounts maintained, number of clients, number of branches, for example. However, "a core limitation of supply side data for estimating access to financial services for individuals or households is the inability of the data to address the nature of the individuals who are the actual users of the services. The presence of branch banks in a given neighbourhood does not say much about the clients who use the branches, and greater branch density need not imply that banking services are available to the poor" (Barr et al., 2007, p. 16).

"Another intrinsic limitation of supply side data is that the data necessarily focus on formal, regulated providers of financial services, about which regulators can offer information, whereas individuals and households use a broad spectrum of informal and semiformal sources, especially in developing countries" (Barr et al., 2007, p. 16). Thus, we need demand side information on usage of financial services as well as preferences to assess the situation of financial inclusion.

Demand side information on financial inclusion can only be obtained from households or firms level surveys by determining core indicators. These types of survey can only be done in a certain interval because of time and costs. Hence, demand side information of financial inclusion cannot be available at a regular frequency like supply side data.

Both demand and supply side information related to financial inclusion include different types of indicators which makes assessment of development of financial inclusion sometimes difficult. Hence, financial inclusion index has been developed to examine the situation of financial inclusion in many countries (Sarma, 2010). It is constructed as a multidimensional index that captures information on various aspects of financial inclusion such as banking penetration, availability of banking services and usage of the banking system. However, people may not understand it easily.

2.5 Drivers

Availing financial service to poor and vulnerable group of people who are normally excluded by formal financial system requires four drivers: institutions, products, policies including regulations, and infrastructure (see Figure 2). There should be right financial institutions with interest, incentives and regulations to reach to the poor people to provide financial services. These financial institutions should have appropriate financial products depending on the needs of people of different strata. Functioning of financial institutions with different products requires enabling environment with appropriate policies and regulations as well as necessary physical and financial infrastructures; the former includes road, electricity, and telecommunication, and the latter includes credit information system, secured transaction, and interoperability (Porteous, 2006).
Figure 2

Drivers of Financial Inclusion

Note. Author's design

These drivers should break the existing vicious circle of financial exclusion. In many developing countries, like vicious circle of poverty, we can see the existence of vicious circle of financial exclusion as shown in Figure 3. Because of being excluded, poor people may have low saving and investment on physical and human capital, which creates low level of income and asset accumulation thereby requiring no needs of financial products and knowledge of it.

Figure 3

Vicious Circle of Financial Exclusion

Note. Author's design
3. Efforts Done for Financial Inclusion

The history of financial development in Nepal is not that long - the first commercial bank was established in 1937, and Nepal Rastra Bank (NRB) was established in 1956 as Central Bank of Nepal. At the time of establishment of NRB, the economy was predominantly agrarian with very limited monetization. There was a widespread circulation of Indian currency (NRB, 1996). NRB spent the first decade after its establishment to set up basic financial institutions such as Nepal Industrial Development Corporation (now merged with Rastriya Baniyaja Bank), Cooperative Bank (now converted into Agriculture Development Bank) and another state-owned commercial bank, Rastriya Baniyaja Bank. NRB abolished the dual currency system and stabilized the exchange rate with Indian currency to increase the use of Nepalese currencies in the economy.

Attempt on financial inclusion began as early as since 1956 when the first credit cooperative was established to provide credit to re-settlers to buy land. Expansion of cooperatives continues since then. Almost after two decade later in 1975, Agriculture Development Bank started Small Farmers Development Program (SFPDP) to organize small farmers, tenants and landless laborers into groups and provide credit under a group guarantee. This program became highly successful so that it was extended to national wide. In this way, lending against group guarantee was started in Nepal a year earlier than the beginning of Grameen Bank by Muhammad Yunus in Bangladesh (Yunus, 2007).

After a decade of establishment, NRB adopted the policy of expanding the branches of commercial banks, which still exists. In the beginning, NRB used to provide compensation to commercial banks to open and operate branches in remote areas to cover the loss in the early years of operation (NRB, 1981). NRB even started providing interest free loans to open branches. This policy remained in operation until few years back.

NRB initiated Small Sector Lending in 1974 directing commercial banks (CBs) to invest 5 percent of their deposit balance in Small Sector (agriculture, small industry and service). After two years, in 1976, NRB renamed the program as priority sector lending (PSL) and increased the ratio of lending to 7 percent of deposits (NRB, 1981). NRB subsequently initiated “Intensive Banking Program” (IBP) in 1981 to boost up PSL lending to the low income group and required commercial banks to lend 8 percent of loans and advances to PSL, which was further raised to 12 percent in 1989. The PSL program was started phasing out since 2002/03 and completely phased out in 2006/07 (NRB, 2005).

NRB introduced the deprived sector lending (DSL) program in 1990 to meet the micro credit demand of the poorer and weaker section of the society. Out of 12 percent of PSL, 3 percent should be DSL. Although PSL was discontinued from 2007, DSL has been continued. Currently, banks and financial institutions (BFIs) have to lend 5 percent of total loans to the deprived sector, which includes many sectors and types of loans which is supposed to go to the deprived people. BFIs can lend to microfinance institutions as part of DSL on the belief that these institutions lend to the poor people.

In the past, along with the policy of expanding mainstream banking institutions and mandatory lending to low income people, the Government of Nepal also implemented many project-based micro financing models in the support of donor agencies (NRB 2005, 2018) such as Production Credit for Rural Women (1981-1995), Cottage and Small Industries Project (1982-1992), Micro-Credit Project for Women (1993-2002), Community Ground Water Irrigation Sector Project (1999-2007), Third Livestock Development Project (1996-2004),

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1 In 2013, there were 9 branches of Nepal Bank Ltd in operation (NRB, 1981)
2 IBP also had provision of group lending at joint liability.

The Government of Nepal established Rural Self Reliance Fund (RSRF) in order to provide wholesale credit to financial intermediaries operating in rural areas namely saving and credit cooperatives and financial NGOs, which were established under Financial Intermediaries Institutions Act, 1999. The number of financial NGOs reached as high as 47 in 2004/05, started declining since 2007/08. In 2013/14, NRB introduced the policy of converting these financial NGOs into for-profit microfinance institutions. RSRF has been handed over to Small Farmer Development Microfinance Institution with the beginning of 2019/20.

The Government of Nepal and Nepal Rastra Bank established five Rural Development Bank in five development regions between 1992-1996 closely based on the Grameen Banking model of Bangladesh, credit plus approach, to provide credit to the poorer households, mainly to women (NRB, 2005). Since 1999, replicating the Rural Development Bank model, the private sector was also allowed to open micro-finance institutions. Substantial expansion of microfinance institutions registered overtime thereafter because of soft licensing policy of NRB in order to increase access to finance in rural and remote areas where mainstream BFIs do not like to go.

Still, although NRB has put moratorium on providing license to open any sort of banking institutions in recent years, branch expansion policy of NRB tends to encourage and push them to go to rural and remote areas. To ameliorate demand side constraint, NRB has barred BFIs on charging fee on basic financial services such as opening account, issuing cheque, closing account after 6 months of opening, activating dormant account, providing bank statement, clearing cheque electronically and providing any branch banking service (ABBS) up to Rs. 200,000.

In recent years, NRB has been giving focus on enhancing financial literacy, cashless economy, consumer protection and development of digital payment and banking. "Opening bank account" has been launched by the government since April 2019 focusing on opening bank accounts of Nepali citizens who currently do not have any bank account. For all the accounts opened under this scheme, banks deposit Rs.100 into customer’s account. Before that, in May 2016, the government had also announced a campaign that entitled Bank Account for Every Nepali with the provision of opening zero balance account and also started depositing all government’s payments in bank account.

Labour Bylaw 2018 has made the provision that all kinds of employment agencies, companies or individuals engaged in any sector have to compulsorily pay the salary of their staff through the banking system. Since February 2015, remittance payment beyond Rs. 100,000 has to be made through bank account or cheque instead of cash. The limit was revised up to Rs. 200,000 in July 2017. Effective July 2017, the government has made provision of using banking instrument while doing sale or purchase of goods and service of value Rs. 1.0 million or more.

4. Progress of Financial Inclusion in Nepal

Financial inclusion in Nepal has been expanding over time because of these efforts done so far, but is not adequate yet. Since the assessment of financial inclusion has both demand and

3 NRB provided temporary license to conduct limited banking activities to NGOs during 1994-1998. With the enactment of Financial Intermediaries Institution Act, 1999, these NGO were required to obtain license again.

4 Rs. is abbreviated form of Nepalese currency, Rupees. As a reference for exchange rate, 1 US dollar equals Rs. 117.13 as per Nepal's central bank buying rate as of Dec. 23, 2020.
supply side dimensions, both dimensions of the situation of financial inclusion are reviewed and compared here based on the available data.

### 4.1 Demand Side Situation

The first study on assessing demand side situation of access to finance in Nepal was done by the World Bank in 2006 by surveying 1710 households in 49 districts (Ferrai, 2007). The study found that only 28 percent of Nepalese households had an account with or loan from a bank. Financial NGOs and cooperatives served 18 percent of households. These institutions were mostly preferred by low-income households. Microfinance Institutions (MFIs) served just 4 percent of households – mainly poor, rural ones at that time.

As per this study, about 38 percent of households had an outstanding loan exclusively from the informal sector and only 15 percent obtained loans from the sector which includes all NRB licensed BFIs, cooperatives and financial NGOs. Informal lenders were the preferred source of working capital for small businesses. At that time, 69 percent of foreign remittance came through informal channel and only 6 percent of remittances were saved in financial institutions (Ferrari, 2007).

After 8 years of the first demand side survey on access to finance, UNCDF conducted another demand side survey on financial inclusion based on FinScope methodology by covering a representative sample of 4,014 adults in Nepal, aged 18 years and above across 70 districts (UNCDF, 2014). This survey covered individuals rather than households; the study covered both access and usage of financial service in a broader way by categorizing the users and financial service explicitly. Hence, findings of it are not directly comparable with the earlier World Bank's survey.

The survey found that 61 percent of Nepalese adults were formally banked (40 percent from banks and 21 percent from other formal channels), while 21 percent used informal channels and 18 percent remained financially excluded (Table 3). In line with global trends, the survey findings also showed men had higher levels of access to banking services and were more financially included compared to women in Nepal. Gender difference is the reflection of gender bias and nature of engagement in economic activities. Compared to rural areas, 20 percent more adults in urban areas were banked, although the completely excluded proportion was the same. More than double proportion of adults living in rural areas than urban areas obtained financial service from informal sources.

This FinScope survey categorizes the users into six different types such as salaried workers, MSMEs, remittance receivers, farmers, irregular earners and dependent based on the main source of income and examines access as well as uses of four different types of financial products such as payment, savings, credit and insurance. The survey does not classify the users into different income and age groups, however.

As shown in Table 3, two-third of salaried workers had access to bank, which is highest among the six user groups, compared to just one-fourth for irregular earners who had the least access to bank (Table 3). Comparatively, 30 percent of remittance receivers used the other formal channel and is the highest among six groups. One-third of irregular earners used informal channel, which is the highest proportion among six user groups. The most excluded group is dependants – one third of them are completely excluded, followed by irregular earners.

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5 All financial NGOs have been converted into MFIs in 2018/19.
6 Includes commercial banks (A Class), development Banks (B class), finance companies (C class) and Micro-finance Institutions (D Class).
7 Includes non-bank formal financial institutions such as cooperatives.
8 Includes money lenders, family and friends, and saving groups.
(one-fourth), while the least excluded users are remittance receivers (only 4 percent). Farmers are the second largest users who use informal source of finance - 16 percent of them are excluded and only 37 percent are banked. About 51 percent of MSMEs are banked, which is the third major users having access to banks; however, 12 percent of them are completely excluded (Table 3).

**Table 3**

*Overall Financial Inclusion Scenario (% of adult)*

<table>
<thead>
<tr>
<th></th>
<th>Bank</th>
<th>Other Formal</th>
<th>Informal</th>
<th>Excluded</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>40</td>
<td>21</td>
<td>21</td>
<td>18</td>
</tr>
<tr>
<td>Urban</td>
<td>56</td>
<td>15</td>
<td>11</td>
<td>18</td>
</tr>
<tr>
<td>Rural</td>
<td>36</td>
<td>22</td>
<td>24</td>
<td>18</td>
</tr>
<tr>
<td>Male</td>
<td>45</td>
<td>19</td>
<td>20</td>
<td>16</td>
</tr>
<tr>
<td>Female</td>
<td>36</td>
<td>21</td>
<td>23</td>
<td>20</td>
</tr>
</tbody>
</table>

**Financial service usage, by target market**

<table>
<thead>
<tr>
<th>Target Market</th>
<th>Bank</th>
<th>Other Formal</th>
<th>Informal</th>
<th>Excluded</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaried workers</td>
<td>66</td>
<td>17</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>MSMEs</td>
<td>51</td>
<td>21</td>
<td>16</td>
<td>12</td>
</tr>
<tr>
<td>Remittance Receivers</td>
<td>52</td>
<td>30</td>
<td>14</td>
<td>4</td>
</tr>
<tr>
<td>Farmers</td>
<td>37</td>
<td>24</td>
<td>24</td>
<td>16</td>
</tr>
<tr>
<td>Irregular Earners</td>
<td>25</td>
<td>16</td>
<td>33</td>
<td>25</td>
</tr>
<tr>
<td>Dependants</td>
<td>29</td>
<td>17</td>
<td>21</td>
<td>33</td>
</tr>
</tbody>
</table>

*Note.* UNCDF (2014) and UNCDF (2016)

Table 4 presents product wise access to financial services. More than one-third of adults use the bank for the payments, but a large chunk, e.g., 46 percent are still excluded in using payment services indicating predominant use of cash. This could be because income and wages are paid and transactions are done mostly using cash\(^9\). Dependants, irregular earners, farmers and MSMEs transacts mostly in cash since significant portion of them are found excluded (Table 5). This situation must have changed since 2014 because of several policy measures that have been taken to lower the use of cash as explained above.

As shown in Table 4, 27 percent of adults save in banks, another 13 percent save in other formal sector, and 16 percent save through informal mechanism. Including 1 percent saving at home or with household members, 44 percent are excluded from saving mechanism because of lack of enough income to save and lack of easy access to formal financial institutions (UNCDF, 2016, p. 60). Among six user groups, more than half (54%) of salaried workers use bank for saving, while slightly higher than one quarter do not save at all (Table 5). Only 12 percent of irregular earners save in bank, the lowest among six user groups. About 58 percent of irregular earners do not save, followed by 57 percent dependants and 53 percent remittance receivers, which could be due to not having enough income to save.

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\(^9\) 64 percent of the adult population use cash and other similar means for transactions; only 36 percent use banks; and only 10 percent of total adult use bank account to receive salary or wages, while 81 percent get paid almost exclusively in cash (UNCDF, 2014, UNCDF, 2016).
Table 4
Product wise Financial Inclusion Scenario (% of adult)

<table>
<thead>
<tr>
<th></th>
<th>Bank</th>
<th>Other Formal</th>
<th>Informal</th>
<th>Excluded</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payment</td>
<td>37</td>
<td>11</td>
<td>6#</td>
<td>46</td>
</tr>
<tr>
<td>Savings</td>
<td>27</td>
<td>13</td>
<td>16</td>
<td>44*</td>
</tr>
<tr>
<td>Credit</td>
<td>10</td>
<td>8</td>
<td>28#</td>
<td>54</td>
</tr>
<tr>
<td>Insurance</td>
<td></td>
<td>11</td>
<td>9</td>
<td>80</td>
</tr>
</tbody>
</table>

Note. UNCDF (2016)
* included saving at home, # included family and friend

Only 10 percent of adults access credit from bank and another 8 percent from other formal channel. About 28 percent of adults obtain credit from informal providers, which also include family and friends. More than half (54 percent) of adults are completely excluded from getting credit (Table 5).

Table 5
Target Market and Productwise Financial Inclusion Scenario (% of adult)

<table>
<thead>
<tr>
<th></th>
<th>Salaried workers</th>
<th>MSMEs</th>
<th>Remittance Receivers</th>
<th>Farmers</th>
<th>Irregular Earners</th>
<th>Dependants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank</td>
<td>64</td>
<td>49</td>
<td>51</td>
<td>33</td>
<td>21</td>
<td>28</td>
</tr>
<tr>
<td>Other Formal</td>
<td>9</td>
<td>8</td>
<td>28</td>
<td>13</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
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<td>3</td>
<td>12</td>
<td>4</td>
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<td>7</td>
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<tr>
<td>Excluded*</td>
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<td>9</td>
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<td>58</td>
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<tr>
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<tr>
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<td></td>
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<tr>
<td>Bank</td>
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<td>10</td>
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</tr>
<tr>
<td>Other Formal</td>
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<td>4</td>
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<tr>
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<td>21</td>
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<tr>
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<tr>
<td>Insurance</td>
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</tr>
<tr>
<td>Other Formal</td>
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<td>23</td>
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<td>7</td>
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<tr>
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<td>8</td>
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<td>13</td>
<td>6</td>
<td>8</td>
</tr>
<tr>
<td>Excluded</td>
<td>64</td>
<td>69</td>
<td>85</td>
<td>79</td>
<td>88</td>
<td>85</td>
</tr>
</tbody>
</table>

Note. UNCDF (2016)
* included saving at home, # included family and friend

In this way, access to credit from formal financial institution is very limited. About 19 percent of salaried workers get credit from bank, which is the highest among six user groups (Table 5). About one-third of farmers and 38 percent of irregular earners, which is the highest among others, use credit from informal sources. Large segment of all user groups are deprived of access to credit. Informal providers are the largest financial service providers in terms of number of clients – 60 percent of total credit users, mostly low income people (UNCDF, 2016,
Money lenders in Nepal were still featured highest as a source of credit – 82 percent of adults agreed that money lenders were an important part of their community (UNCDF, 2014). Access to credit might have improved to some extent since 2014 given the expansion of formal financial institutions in recent years. But, if we look at the recent number of loans and deposit accounts from supply side data which are presented below, access to credit from formal financial institution is still limited.

Insurance coverage was found very low in FinScope survey in 2014. About 28 percent of adult population was found aware of insurance, while only 11 percent claimed to have a form of insurance (UNCDF, 2014). Besides the low awareness of insurance, the second most important reason for not having insurance is affordability (24 percent of adults). Among six user groups, 29 percent of salaried workers and 23 percent of MSMEs had access to insurance, and these are the top two users of insurance (Table 5).

4.2 Supply Side Situation

This paper covers the development of supply side related to financial inclusion, especially focusing from 2014 onwards when the last demand side survey was carried out (excluding the insurance sector)10. Further, supply side also includes several indicators for assessing the increase in financial access and inclusion.

Figure 4

Numbers of Branches of Banks and Population per Branch

Note. Nepal Rastra Bank

As seen in Figure 4, the number of branches of deposit taking bank and financial institutions (A, B and C class)11, which was increasing at modest rate until 2017, started increasing at a higher rate since then reaching 5,708 as of mid-July 2020. With the rapid expansion of bank branches, population per branch declined steeply. This was true especially after 2017, when the ratio lowered to 5,255 people per branch on average (Figure 4). However, distribution of branches mainly concentrated in urban and semi-urban areas. Out of 77 districts,

10 The number of insurance companies has increased from 27 (9 life, 17 non-life and 1 Reinsurance) in 2014 to 40 as of 2020 (19 life, 20 non-life and 1 Reinsurance).

11 A class means commercial banks, B class means development banks and C class means finance companies; all of them are allowed to mobilize deposits and lend, but only minor differences exist in foreign currencies transactions.
26 districts have population per branch lower than the national average, so three-fourth districts have population per branch higher than the national average, reflecting diversity of access to branches of banks. About 22 percent of branches are in Kathmandu Valley (Kathmandu, Lalitpur and Bhaktapur districts).

**Figure 5**

*Some Financial Inclusion Indicators*

![Graphs showing financial inclusion indicators](image)

*Note.* Nepal Rastra Bank

The growth of the number of ATMs has remained comparatively higher after 2017 in line with branch expansion. Compared to the growth of debit card, the number of credit cards has increased sharply since 2016, after some downfall in 2015. More importantly, within the period of 7 years between 2013 and 2020, the number of deposit accounts has increased by 2.85 times. The year 2018/19 and 2019/20 registered a growth 4.3 million and 4.6 million new accounts. However, the number of loan accounts just increased by 1.82 times during the same period. It shows the substantial rise in use of banks for saving purpose\(^\text{12}\), but a proportional rise

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\(^{12}\)Recently conducted study by NRB has shown that 60.9 percent of populations now have bank accounts after removing multiple accounts holding by same individuals in A, B, and C banking institutions as of mid-June 2019 (NRB, 2019). Many deposit accounts are not actively used.
in use of credit from banks has remained sluggish. In 2013, 7.4 percent of depositors were using credit from banks, but that ratio declined to 4.8 percent by 2020. Though substantial increment in numbers, bank credit is relatively still out of reach of many. This reflects that financial resources are being utilized by limited people who can have access to these financial institutions.

Branchless banking is considered an alternative way to expand basic financial services in a cost effective way to people residing mainly in remote areas, where the operation of brick and mortar branch is financially infeasible. The number of branchless banking centres increased steadily in recent years until slowing down in 2019/2020 (Figure 5). After decline in 2017, the number of branchless customers has increased continuously. However, the data on the usage of these branchless banking centres are not available.

Microfinance institutions play a vital role in expanding access to finance and making financial system more inclusive. The expansion of both the number of MFIs and their branches has remained very impressive in recent years in Nepal. Between mid-July 2013 and mid-July 2020, the number of branches of MFIs increased by more than 6 times reaching more than 3,900 from just 646 (Figure 6). With the expansion of branches, the number of members increased by 3.7 times and the number of borrowers by 3.1 times during the same period. As of mid-July 2020, there were 4.69 million members and 2.78 million borrowers of MFIs. The expansion of members and borrowers remained less than the rate of expansion of branches of MFIs, indicating some kind of saturation in finding new customers. However, the outstanding loans provided to borrowers jumped up by about 11.2 times during this period reflecting increased flows of resources towards this sector to fulfil the unmet credit demand of poor people. Sharp increase in branches as well as other indicators of MFIs between 2018 and 2019 is due to conversion of 24 financial NGOs operating in the past into for-profit microfinance institutions.

**Figure 6**

*Expansion of MFIs branches and their customers*

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13 Average deposit size is lower than GDP per capita but average loan size is about 17 times higher than GDP per capita in Nepal in 2020. Such ratios are equal to or less than GDP per capita in more developed countries (Barr et al., 2007).

14 "If not implemented properly, efforts to promote financial inclusion can lead to defaults and other negative effects" (World Bank, 2014, p. 2).
Note. Nepal Rastra Bank

Saving and credit cooperatives, which collect deposits and lend to its members, also expanded substantially in the recent decades until 2013 before a slowdown in growth after that time. Recent data of saving and credit cooperatives are not available after 2017 because many cooperatives are now under the jurisdiction of local bodies as per the new constitution, thereby lacking the aggregation of the performance of these cooperatives. By 2017, there were 3.4 million members in saving and credit cooperatives with deposit mobilization of Rs. 217.5 billion and lending of Rs. 179.9 billion (Figure 7). In addition to saving and credit cooperatives, there are thousands of multipurpose cooperatives also being engaged in some sort of financial intermediation.

Figure 7
Situation of Saving and Credit Cooperatives

Note. Department of Cooperative, Government of Nepal

4.3 Global Findex Data

World Bank’s Global Findex data also provide information on financial inclusion from different perspectives. Percentage of adult having bank account in Nepal has increased from 25 percent in 2011 to 45 percent in 2017 (Table 7). Eight percentage point of gender disparity in accessing bank account still exists as of 2017 in Nepal.

Table 7
Percent of Adult having Bank Account

<table>
<thead>
<tr>
<th>Indicators</th>
<th>2011</th>
<th>2014</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Account (% age 15+)</td>
<td>25</td>
<td>34</td>
<td>45</td>
</tr>
<tr>
<td>Account, male (% age 15+)</td>
<td>30</td>
<td>37</td>
<td>50</td>
</tr>
<tr>
<td>Account, female (% age 15+)</td>
<td>21</td>
<td>31</td>
<td>42</td>
</tr>
<tr>
<td>Account, primary education or less (% ages 15+)</td>
<td>19</td>
<td>30</td>
<td>42</td>
</tr>
<tr>
<td>Account, secondary education or more (% ages 15+)</td>
<td>42</td>
<td>52</td>
<td>59</td>
</tr>
<tr>
<td>Account, income, poorest 40% (% ages 15+)</td>
<td>14</td>
<td>24</td>
<td>38</td>
</tr>
<tr>
<td>Account, income, richest 60% (% ages 15+)</td>
<td>33</td>
<td>40</td>
<td>50</td>
</tr>
</tbody>
</table>

Note. Global Findex Data
Financial inclusion differs as per the distribution of income – about 38 percent of adult from bottom 40 percent had bank account, while 50 percent of richest 60 percent had bank account, though the gap has been narrowing down between 2011 and 2017. In this way, income inequality determines the inequality of financial access. Percentage of people having bank account increases with increasing education, and the gap between percentage of people having bank account with primary or less education and secondary or more education has been gradually lowering. This shows the increasing financial inclusion in Nepal.

Table 8
Usage of Financial Services

<table>
<thead>
<tr>
<th>Indicators</th>
<th>2011</th>
<th>2014</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Saved at a financial institution (%), age 15+</td>
<td>10</td>
<td>16</td>
<td>17</td>
</tr>
<tr>
<td>Borrowed from a financial institution (%), age 15+</td>
<td>11</td>
<td>12</td>
<td>13</td>
</tr>
<tr>
<td>Borrowed from family or friends (%), age 15+</td>
<td>33</td>
<td>35</td>
<td>53</td>
</tr>
<tr>
<td>Debit card ownership (%), age 15+</td>
<td>4</td>
<td>7</td>
<td>9</td>
</tr>
<tr>
<td>Debit card ownership, male (%), age 15+</td>
<td>6</td>
<td>10</td>
<td>12</td>
</tr>
<tr>
<td>Debit card ownership, female (%), age 15+</td>
<td>2</td>
<td>4</td>
<td>6</td>
</tr>
<tr>
<td>Sent or received domestic remittances: using an account (%), senders and recipients, age 15+</td>
<td></td>
<td>16</td>
<td>28</td>
</tr>
<tr>
<td>Paid utility bills: using a financial institution account (%), age 15+</td>
<td>0</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Received wages: into a financial institution account (% wage recipients, age 15+)</td>
<td>12</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td>Received payments for agricultural products: into a financial institution account (%), age 15+</td>
<td>0</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Used a mobile phone or the internet to access an account (%), age 15+</td>
<td></td>
<td>4</td>
<td></td>
</tr>
</tbody>
</table>

Note. Global Findex Data

Table 8 presents the usage of financial services. Though marginally increasing, percentage of adults saving at a financial institution remained just 17 percent as of 2017 in Nepal. Percentage of adults who have borrowed from a financial institution is 4 percentage point lower than that of saving in Nepal. Gap between percentage of people saved and borrowed have widened after 2011. More than half of adults (e.g., 53 percent) borrowed from
family or friend in Nepal in 2017. This situation vindicates a weak access to credit for ordinary people in Nepal.

Now, financial inclusion concerns with not only to traditional financial services, but also the use of modern financial technology which is supposed to lower time and costs and make access to financial services convenient and affordable. In this context, use of debit card, though slightly improving, was still limited to less than 10 percent of adults as of 2017 in Nepal (Table 8). This might have improved then after as we saw the expansion of number of debit cards issued in the earlier section. Wide gender disparity can be observed in use of a debit card – fewer female compared to male use debit card.

Percentage of remittance senders using a bank account increased from 16 percent in 2014 to 28 percent in 2017 in Nepal (Table 8). Just 2 percent of adult used an account in financial institution to pay bill in 2017 in Nepal. Only 15 percent of wage recipients receive wages into a financial account in Nepal. Recently policy of government to pay wages into bank account might have increased this ratio. Just 1 percent of adults receive payment of agriculture products in an account in financial institution in Nepal. Obviously, model of payment in agriculture activities are still predominantly in cash. About 2 percent of adults use mobile phone or internet to access account in Nepal.

5. Constraints for Financial Inclusion

Despite several efforts for last six decades, the level of financial inclusion is not satisfactory, although some improvement was made, and still below India and Sri Lanka (Shrestha, 2020). There are several constraints and barriers for financial inclusion in Nepal. Difficult geographical terrain and scattered settlement, mainly in hilly and mountain regions which together occupy 83 per cent of total land, is main obstacle to make access to finance easier. People living in these areas find that the time and opportunity cost of travelling to the nearest bank is high.

Geographical barrier for financial inclusion can be overcome by using information technology. With the rapid penetration of mobile phones in the country, one can expect using of mobile banking can penetrate in remote areas. However, the use of mobile (internet and SMS) banking is just started and mainly limited to urban areas. Digital and financial literacy is required for people to be capable of using these new techniques. Since one-third of adult population are illiterate, it is not easy to expand digital mode of banking due to lack of absorption capacity.

Another important barrier of using financial service is the predominance of subsistence nature of economic activities. People engaging in subsistence economic activities do not feel necessity of having formal banking services. Their needs are not big enough so that they manage finance need in the society through using informal channel. Further, because of ignorance and low level of education, people living in rural areas with low income people feel difficult to fulfil the documentation requirements to open account or to take loan from formal financial institutions. Another barrier to use of saving products is that most people do not have enough income to save, which can then be deposited in banks. The perception that formal financial institutions are ‘not for me’ also prevents some section of people approaching to use saving products (UNCDF, 2016).

On supply side, lengthy and time consuming process of loan approval and collateral-based lending approach also discourage many potential borrowers to use formal financial institutions to take credit. On average, an individual loan approval process can take up to two weeks (UNCDF, 2016, p88). Although microfinance institutions provide loans without collateral but against group guarantee, they are also mostly concentrated in urban and semi-
urban areas, and charge comparatively higher interest rate on account of higher operating costs and highly profit motivated objective.

Global Findex data presents the following reasons for not having bank account in Nepal. The main reason of not having bank account is due to insufficient fund. Because a large chunk of people are still near to absolute poverty line, they do not have enough income to make saving to use bank account. Second, most important reason of not having bank account is because financial institutions are far away, which natural is given geography and pattern of settlement as discussed above.

Table 9
Reasons for not having bank account in 2017

<table>
<thead>
<tr>
<th>Reasons</th>
<th>%, age 15+</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insufficient funds</td>
<td>40</td>
</tr>
<tr>
<td>Financial institutions are too far away</td>
<td>20</td>
</tr>
<tr>
<td>Someone in the family has an account</td>
<td>18</td>
</tr>
<tr>
<td>Financial services are too expensive</td>
<td>17</td>
</tr>
<tr>
<td>Lack of necessary documentation</td>
<td>10</td>
</tr>
<tr>
<td>Lack of trust in financial institutions</td>
<td>8</td>
</tr>
<tr>
<td>Religious reasons</td>
<td>3</td>
</tr>
<tr>
<td>No need for financial services only</td>
<td>1</td>
</tr>
<tr>
<td>Insufficient funds</td>
<td>40</td>
</tr>
</tbody>
</table>

Note. Global Findex Data

6. Conclusions

Financial inclusion is multi-dimension because people are financially excluded due to various reasons – some are voluntary and others are involuntary. Main concern for policy makers is to reduce involuntary financial exclusion through various policy provisions. People may be excluded even in urban areas where physical access is not a barrier. Hence, assessing the situation of financial inclusion requires both supply and demand side (users' perspective) information.

Both demand and supply side information show that the situation of financial inclusion in Nepal has been improving because of several efforts done in the past since 1956 when central bank of Nepal was established. However, a large chunk of adult population is still excluded even from basic financial services. Among others, exclusion is more severe in case of access to credit. Factors such as physical access, low income and lack of awareness are acting as barriers for expanding financial inclusion in Nepal. High collateral requirement (mainly land and houses) and lengthy approval process are main barriers of getting credit.

Scatter settlement with difficult terrain in hilly and mountain regions is a big challenge to increase access to finance in these areas. On the other side, poverty with low income as well as lack of entrepreneurial skill and financial knowledge has been preventing people from using the available financial services. Hence, innovative ways are needed on both demand and supply side of financial inclusion.

Use of Fintech is still lower, application of which can help to increase financial access at lower costs in remote areas. However, people need to be both financial and digital literate, and focus should be given on cyber security. On credit side, much more is needed to be done, such as collateral less credit providing system based on credit history, financial transactions and
other behavioural information. Developing credit scoring system will help to build collateral-less lending system.

Wider network of microfinance institutions and large number of saving and credit cooperatives can be leveraged to make the financial system highly inclusive by availing basic financial services, leaving no one behind by reaching bottom of the pyramid. Mainstream financial institutions can use these MFIs and cooperatives as business correspondent and can do business process innovation to deal with smaller size customers by lowering costs. These non-mainstream financial institutions need to be strengthened by consolidation, government support, modernization and close supervision.

Regular assessment of demand side of financial inclusion is necessary to assess the actual situation of usage and barriers to access the financial services. Existing barriers to access financial service should be removed collaboratively by all stakeholders to avail basic financial services to all strata of population by designing right policies, using new technology, and developing necessary physical and financial infrastructure. Given the gap in financial inclusion, investment in Fintech seems to be viable sector for foreign direct investment and technology transfer in Nepal. In addition, comparison of policy adopted in similar countries could be further areas of research to enrich the concept of financial inclusion and cross-country understanding as well as peer learning.

References


