



A STUDY REPORT ON

ACCESS TO FINANCE OF MICRO, SMALL AND MEDIUM-SIZED ENTERPRISES IN NEPAL



Context and Rationale of this Study

- Micro, small and medium enterprises (MSMEs) are key players on agriculture and other value chain finance as they are the important engines for innovation, economic growth and job creation.
- But they often encounter difficulties in accessing finance.
- Governments and related agencies over the years have been setting up mechanisms to facilitate the flow of finance.
- The result has been an increase in financial inclusion but the extent to which the financing gap has been reduced is not well known.

Objectives of the Study

The overall objective of the study on MSMEs access to finance is to answer difficulties in accessing finance. The specific objectives are to study, analyze and recommend on:

- The gap between financing needs and access to credit and harnessing full potential for MSMEs and financial constraints for these enterprises
- Difficulties faced by the supply side while catering to MSMEs financial needs and demand side while asking for loans
- The most beneficial mechanisms in decreasing/ closing the gap
- The difficulties faced by women entrepreneurs and women led MSMEs to access finance, availability of special provisions for women entrepreneurs and ways to support them
- Use of FinTech and digital finance in increasing access to finance

Study Framework

Study was carried out by following "A Framework for Country Studies on MSMEs Access to Finance in Asia and the Pacific (v.1)" prepared by UNESCAP

The study framework includes the following key contents to guide the scope of study.

- Financial access for MSMEs
- Policy and regulatory framework
- Lending infrastructure and support
- Dedicated banks and funds
- Equity and related support
- Financial Technology (FinTech)
- Business models and partnerships
- Demand-side support

Methodologies used

- Desk review using secondary data
- Primary information collection from banks, MFIs, Entrepreneurs, Business houses and Municipalities through Key Informant Interview (KIIs) and Focus Group Discussions (FGDs)
 - Eleven entrepreneurs of MSMEs in the Far-Western and Eastern part of the country
 - Three MFIs including visit to branch office of Nirdhan in Ilam
 - SMEs department of three commercial banks in Kathmandu and two branches of other commercial banks during field visit
 - Two municipality offices
 - An access to finance program-Sakchyam

FINDINGS

Definition of MSMEs

- Most of the country defines using at least two of the following three indicators
 - Employment
 - Sales Volume
 - Capital investment
- Employment is common in most of the countries.
- Industrial policy 2010 of Nepal uses just Capital for SME definition (up USD0.5 Million Small, up to 1.5 million Medium), but all the three criteria above to define Micro Enterprises
- But banks are using lending size as definition for SME loan
For example: One such bank is using up to fifty million as maximum and one million as minimum while the other is using twenty million as maximum and half a million as minimum.

MSMEs Financing Gap and Causes – Global Scenario

- Estimated over 200 Million of MSMEs are currently operating in emerging economics
- Half of them do not have credit access
- Financing gap of between USD 3-4 trillion in those MSMEs in emerging economics

Causes for such gap:

- Severe information asymmetries
- Prevalence of informal business practices
- High costs of underwriting relative to available margins
- Heterogeneity of the market
- Impediments to MSMEs growth and productivity
- Lack of adequate skills and capacities at the entrepreneur's end and
- Regulatory constraints.

MSMEs In Nepal

- The Government of Nepal (GoN) recognizes the importance of the MSMEs segment to the country's economic development and employment generation
- Most of the leaders and government officials talk extensively about the importance of MSMEs for economic growth
- But not adequate infrastructure and dedicated approach have been developed to promote MSMEs

Role of MSMEs in Nepal

Playing significant role in national economy

- Ninety percent of the total industrial Gross Domestic Product (GDP)
- Creating eighty percent of industrial employment.
- About seventy percent of the total national export
- SMEs contribute about twenty five percent of country's GDP
(contribution from MEs to GDP is still unknown)

Status of MSMEs in Nepal

- Around 240,000 Micro Enterprises- UNDP Microenterprise Program and all MFIs

Of them following SME are registered as company in company registrar office:

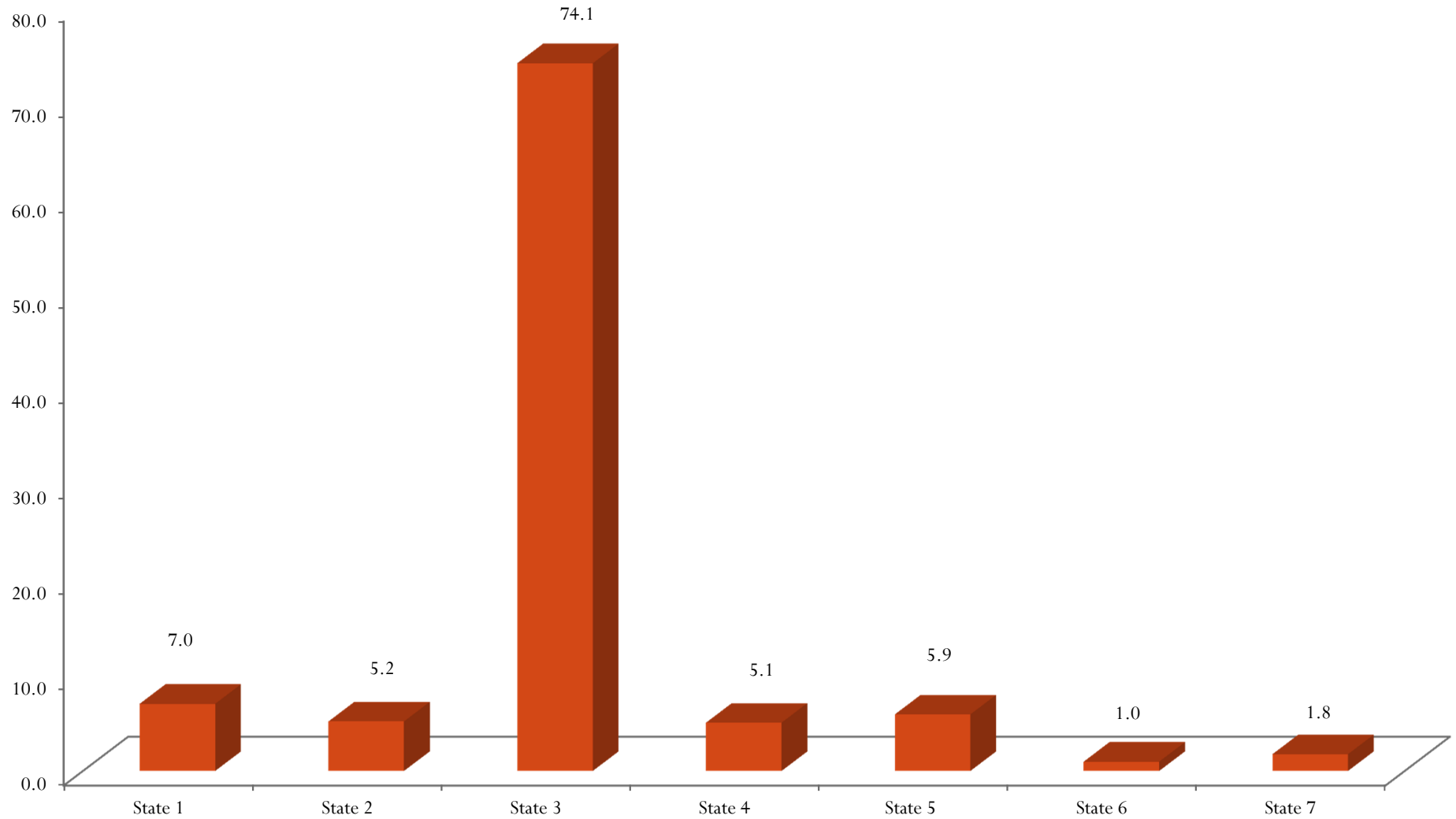
- Around 148,726 Small Enterprises registered as companies
- Around 5,823 Medium Enterprises registered in companies

Others might have registered in local level

Note:

1. There might be several thousands of undocumented MEs operating in Nepal that are not included in above figure
2. Registered but non functional companies are not known

Concentration of Registered MSMEs



Financing Gap in MSMEs

Assumptions and facts used for computing

- Fifty four percent of the MEs do not have financial access (fact)
- Over sixty percent of SMEs do not have access to capital (ADB report)
- Registered MEs need at least USD 2,000 capital (interview) but NRB put USD 3,000 minimum threshold for enterprise
- Non Registered MEs need at least USD 1,000 Capital (interview)
- SMEs need USD 30,000 capital (ADB report)
- Number of Small Enterprises: 148,726 and Medium Enterprise: 5,823 (fact)
- Number of Microenterprise registered under UNDP ME/ Microenterprise development for Poverty Alleviation (MEDPA: 50% (interview)
- Number of MEs under MEDPA with access to finance: 10,240 (fact)

Financing Gap in MSMEs

- Micro Enterprises (MEs) financing gap : USD 0.17 Billion Million
- Small and Medium Enterprises (SMEs) financing gap - USD 3.07 billion

A total of **USD 3.24 billion** financing gap is found in Nepal for MSME.

Harnessing Optimum MSMEs Portfolio

- Current SMEs portfolio of commercial Banks : five percent of total except three public banks-NBL RBB and ADBL
 - Commercial banks have shown their intention to go up to ten percent for SMEs
- Current MEs portfolio of MFIs : 11.2 percent
 - MFIs are allowed by NRB to go up to thirty three percent
- Harnessing of optimum portfolios can provide up to USD 1.2 Billion (MFIs and banks) –within existing policy and willingness

This will help meet one third of current gap!

Missing Middle

- MSMEs Entrepreneurs requiring medium to long-term financing
- Too big for microfinance but too small and even too risky for commercial banks.
- Current minimum loan size of Commercial Banks-NRs 2.5 million
 - few have less than that but mostly for non-funded facility (guarantee, LOC etc.)
- Current average size of ME loan is less than USD 3,000 (even though they can go up to USD 7,000) but the average need of ME entrepreneurs is USD 5,000
- USD 14,000 loan for women entrepreneurs without collateral is in theory only.

Missing Middle

Supply side issues:

- Costs consideration to commercial banks to reduce the SME loan size – policy support and incentive may help.
- Lack of adequate guidelines and tool for women entrepreneurs loan
- Capacity constraints at MFIs to manage larger size ME loans
- Lack of appropriate credit/financial appraisal tools to cover diverse areas of SME
- Collateral issues

Missing Middle

Demand side issues:

- Lack of adequate products and limited innovation to meet the SME needs
- MSMEs in most of the cases are diverse in terms of their activities, objectives, and loan size and difficult to understand growth potential.
- MSME entrepreneurs lack expertise and face capacity constraints
 - To deal with and satisfy banking system
 - Documenting business model and proposition
 - Legal and regulatory compliances
- Lack of appropriate and adequate collateral

MSMEs Ecosystem

- A comprehensive ecosystem for MSMEs financing is very important to improve financing opportunity for MSMEs
- While developing and strengthening Ecosystem, it is important to put in place:
 - Effective institutional arrangement for BFIs and their regulatory system, separate department for MSMEs and local level unit for MSMEs
 - Supportive schemes such as credit guarantee fund, insurance arrangement
 - Providing avenues for MSMEs to seek information, advice and redress as well as assistance through debt resolution and management programs

MSMEs Ecosystem

Credit Guarantee mechanism

- No proper Guarantee system established in Nepal like in neighboring countries
- Deposit and Credit Guarantee Fund is currently for deposit guarantee only
- DFID access to finance program undertaking some studies to help identify appropriate institutional structure to be setup for providing guarantee mechanism for SME financing

Insurance scheme

- No insurance scheme so far developed focusing MSMEs
- But there are risks associated with MSMEs that needs to cover by insurance:
 - Ten percent death of income earner and eleven percent HH death of member of family
 - Twenty five percent entrepreneurs of MSMEs/family suffered from illness
 - Fifteen percent faced competition, fifteen percent drought, ten percent harvest failure
 - Seven percent faced flood and eight percent faced theft/loss of property

Collateral Issues

- Land and building with access to road is preferred even though NRB has relaxed such condition:
 - Most of Small and Micro entrepreneurs may not have such land or even they have, the value of assets is very high compared to the loan size
 - Average size of ME loan with collateral is less than NRs 300,000 and upper size of group loan without collateral is also the same
 - ME Entrepreneurs prefer to borrow group loan from multiple MFIs rather than pledging high value collateral for small loans
 - No clear guidelines and framework for collateral free loan for women entrepreneurs

Other Findings

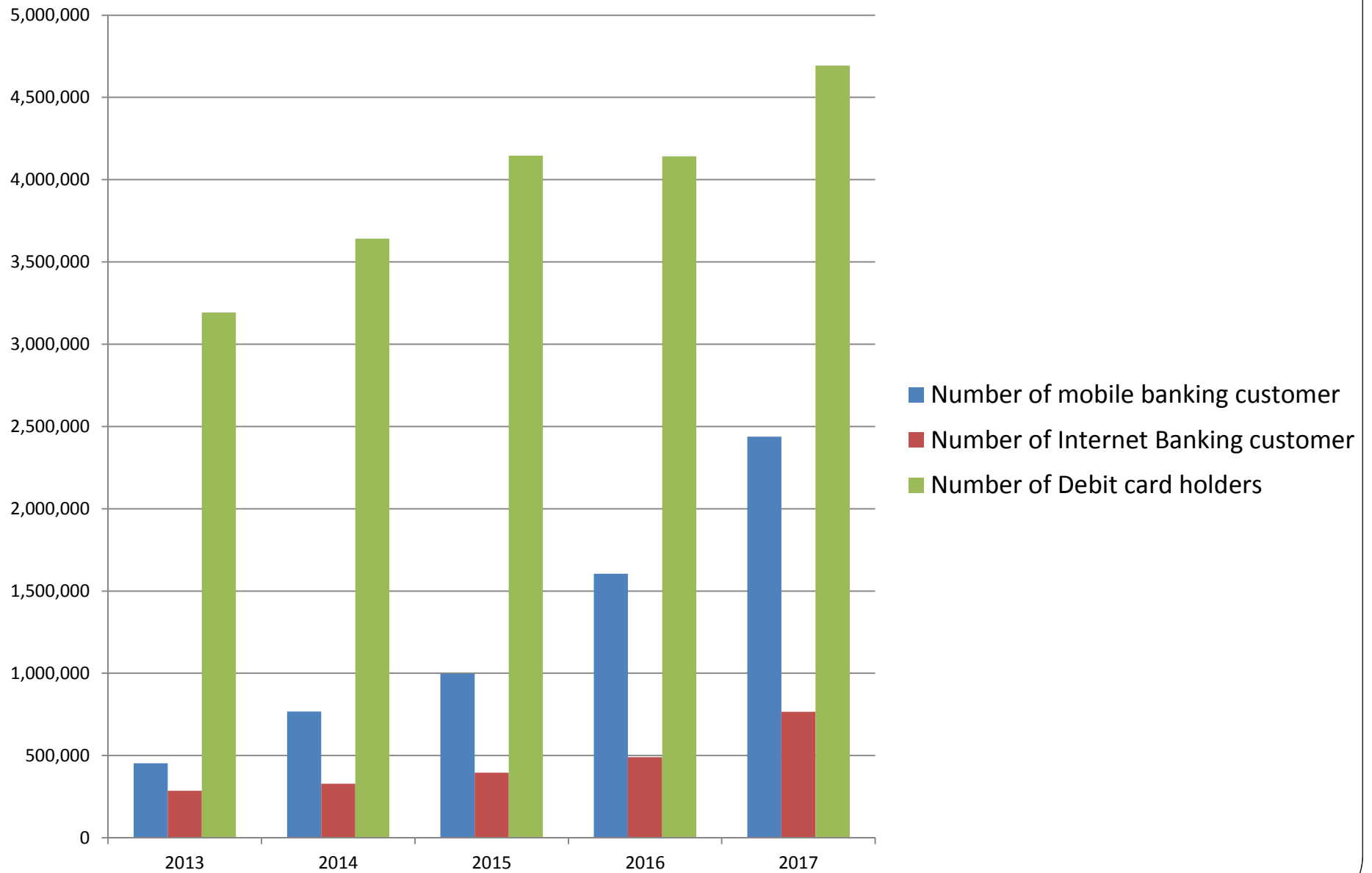
- Interest rate stated in the initial agreement v/s effective rate
- Loan size linked to sales and tax payment even for SMEs (recent monetary policy)
- Forward linkage for value chain support and financing- Bhat Bhateni, Salesberry, Big Mart etc.

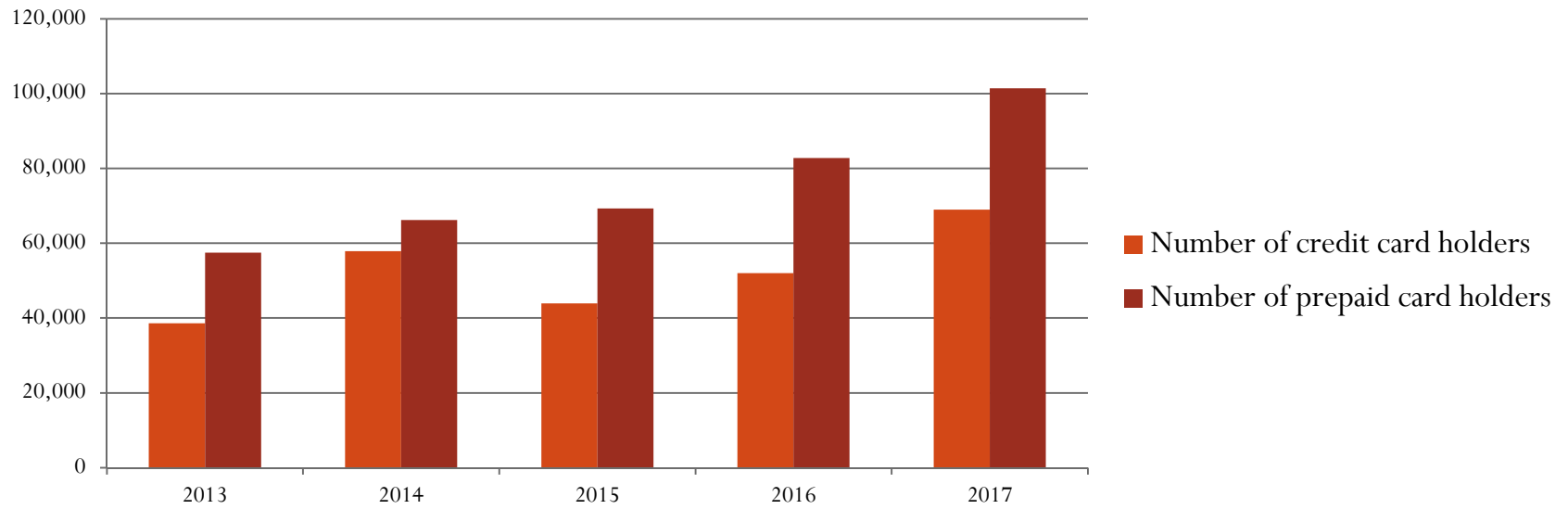
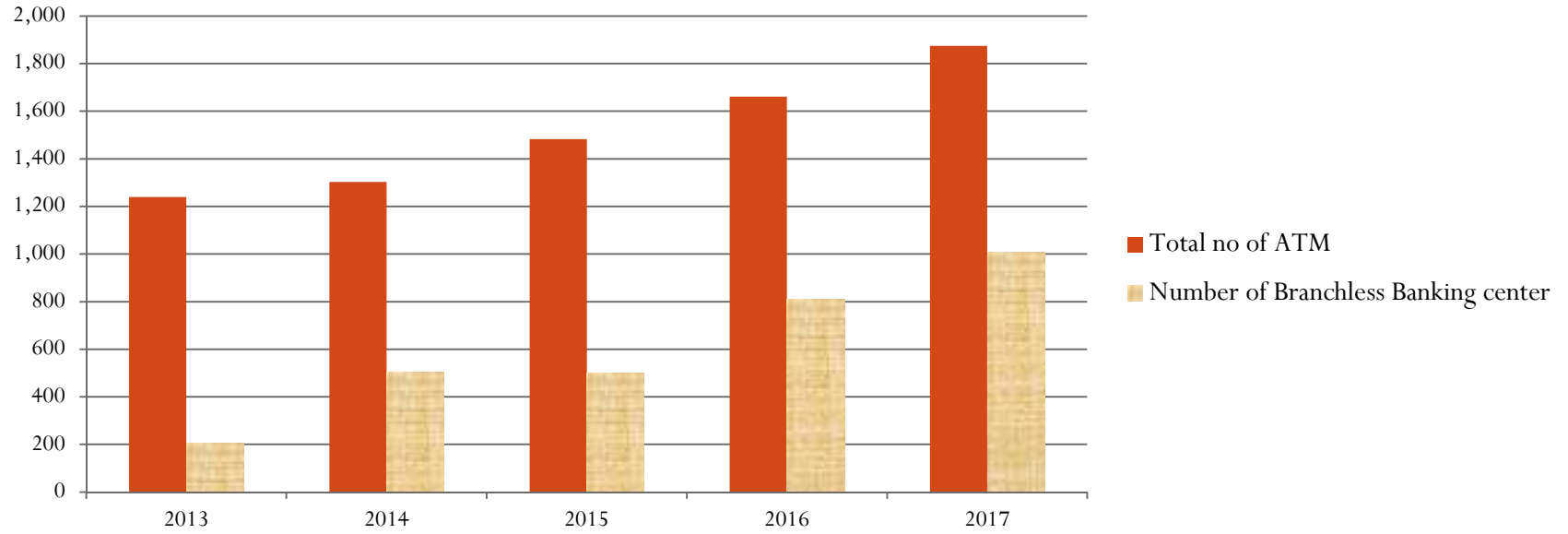
Other Initiative that may Benefit MSMEs

Equity and vender capital financing for MSME

- There are six different entities managing venture capital funds that that may be available for MSMEs also going forward
- For example: One to Watch company has invested in fifteen growing companies with an average funding size of USD 300,000- too big for Micro and small entrepreneurs.
- They are also brining additional investment of Euro 20 Million

Digital Financing in Nepal (FinTech)





Few latest initiatives for FinTech in Nepal

At Commercial Banks

BLB unit for KYC (from simple POS to hybrid Tablet) beyond cash in and cash out - initial loan processing.

At MFIs level

- Tablet Banking for financial transactions
- Women agent to operate for financial transactions through Tablet
- Transaction input in real time basis where possible or offline recording and data transferring when online
- Mobile wallet such as IME pay, Prabhu etc. focusing on rural areas

But these are general technologies and not specifically MSME focused, but MSME can also benefit.

Demand Side Initiatives

- Financial Literacy using technology-IVR with short messages
- Small Video clip on financial and business literacy
- Establishing MEDPA unit in all 753 local government levels

RECOMMENDATIONS

1. Improving Financial access for MSMEs through enabling policy and regulatory environment

- Easing Collateral requirements:
 - Use the local market value of the assets rather than making the access road mandatory
 - Each bank should prepare guidelines and necessary tools to appraise loan for women entrepreneurs without physical collateral following the NRB framework

- Harnessing optimal MSMEs loan portfolio both at MFIs and Commercial banks
 - Separating loan size between group loan and ME loan at MFI level
 - Mandate all banks to maintain at least 10 percent of the portfolio in SME or put SME finance under priority lending fixing percentage:
 - A fixed percentage for non-collateralized loans
 - A fixed percentage of the non-collateralized SME loans for women entrepreneurs
 - Maintain record of MSME portfolio at bank and publish it regularly
 - Specific definition for Micro, small and Medium enterprises for financing purpose across BFIs

- Simplifying (easing) tax requirement for MSME entrepreneurs
 - Differentiated tax bracket and simplified tax system

2. Lending infrastructure and support

Promoting Ecosystem for MSMEs

- Exploring possibilities of establishing a separate division at NRB for MSMEs
- Policy and regulatory support for BFI for MSMEs lending
 - Example relaxing in provisioning, differentiating spread rate etc.
- Strengthening the MEDPA units at local government level to perform as MSMEs capacity strengthening unit
- Institutionalizing Guarantee mechanism to support MSMEs -Initiative taken by DFID program with the strategic guidance from UNCDF should continue.
- Promoting micro insurance scheme for entrepreneurs of MSMEs
 - Mandatory Insurance for SMEs loans without collateral
 - Provision of premium subsidy for women entrepreneur using CSR fund
- Linking MSME with big markets for MSMEs value chain and easing financing constraints

- Strengthening Credit Information Center (CIC)'s capacity to establish credit information for each and every borrowers in BFI including MFIs
- Involving credit rating agency with appropriate regularity framework

3. Financial Technology (FinTech)

- Expanding FinTech targeting to MSME that can also help review borrowers' past loans performance
 - Expanding Tablet/ Smartphone banking
 - Internet Banking for MSME borrowers
 - Use of Social Media for KYC and loan appraisal
 - Open source system for financial services with application programming interface to serve multiple institutions and millions of people

4. Demand side support

- Using technology for financial literacy-Media, social network, IVR
- Developing short video/audio on financial literacy (complete package) and telecasting it through TV/Radio by encouraging all TV/Radio stations to use their CSR for broadcasting/telecasting this.

THANK YOU