

Financial Inclusion in Nepal: Policy Review and Prescriptions

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Abstract

With financial inclusion playing a vital role in reducing poverty and income disparity, it is emerging as a top priority for policymakers and regulators. A large number of countries have introduced comprehensive measures to improve access to and usage of tailored financial services. Greater financial inclusion is achieved when all economic activities and segments of the society have access to financial services with ease and at minimum cost. In the case of Nepal, though the need for financial inclusion by encompassing more and more of the excluded population by the formal financial system has been regularly emphasized in the country's policy framework, a large section of population still remains outside the formal financial system. This paper, after assessing some relevant data on financial inclusion, reviews the policy measures implemented for enhancing it. The majority of the measures could not be executed to the degree desired due to problems of low financial literacy, paucity of infrastructural facilities as well as inadequate technology-based facilities, among others. Against this perspective, this study seeks to provide some prescriptions for enhancing financial inclusion in the country. These include, among others, promotion of financial literacy programs, launching of digital financial services, formulation of National Financial Inclusion Strategy, implementation of a Financial Inclusion Roadmap and according special role to microfinance institutions.

Key Words: Financial Inclusion, Access to Finance, Microfinance

JEL Classification: G21, G28, O16

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I. INTRODUCTION

Financial inclusion refers to a process that ensures the ease of access, availability and usage of the formal financial system for all members of an economy. Policymakers view this as a mechanism to improve people's livelihoods, lower poverty, and advance economic development. An inclusive financial system has several merits. It facilitates efficient allocation of productive resources and thus can potentially reduce the cost of capital. In addition, access to appropriate financial services can significantly improve the day-to-day management of finances. An inclusive financial system can help in reducing the growth of informal sources of credit, which are often found to be exploitative.

Financial inclusion is being viewed as a crucial global priority. Governments, international development agencies, academics, and the private sector, have all placed financial inclusion on the top of the agenda. The World Bank has made universal financial access by 2020 as one of its aims. This rising emphasis on financial inclusion demonstrates a growing realization of its potentially transformative power to accelerate development gains. The last few years have seen the development of national financial inclusion master plans and strategies in many countries, along with efforts to regulate microfinance agencies to better protect the users of their services (Rillo, 2014).

Financial inclusion aims at benefiting the world's poor, the vast majority of who are unable to avail themselves of the fundamental tools of economic self-determination, including savings, credit, insurance, payments, money transfer, and financial education. (McKinsey & Company, 2010). In other words, one of its objectives is to bring the excluded population that is currently in the informal, undocumented, unmonitored and unregulated system into the formal, transparent, and protected financial system (Thorat, 2006).

According to the Maya Declaration, an important aim of financial inclusion is lifting less privileged people and the rural poor out of poverty by helping them build better and more dignified lives.¹ Well-designed financial inclusion programmes can help the rural poor start businesses and help small businesses to grow.

As in many other developing countries, Nepal can use financial inclusion as a platform not just for growing the financial sector but more as an engine for driving an inclusive economic growth. It is important to recognize that in the policy framework for development of the formal financial system, the need for financial inclusion and covering more and more of the excluded population by the formal financial system has always

¹ The Maya Declaration is the first global and measurable set of commitments by developing and emerging country policy makers to unlock the economic and social potential of the poorest people through greater financial inclusion. It was established at the Alliance for Financial Inclusion's (AFI) Global Policy Forum in 2011, with AFI network members collectively adopting its financial inclusion policy principles. There were 80 member institutions from 76 countries at the time of the Forum. The network has since expanded, growing to 100 member institutions. For details see, <http://cfi-blog.org/2013/08/29/forty-countries-and-counting-committed-to-the-maya-declaration/>

been consciously emphasized. What has now come to the fore is that even after decades of such emphasis, there are large segments of the society that remain excluded from the financial system.

On the basis of the foregoing background, this paper attempts to assess the policy measures undertaken in the past as well as propose some steps for promoting financial inclusion in Nepal. After providing a short methodology of this policy paper in Section II, a literature review on financial inclusion is briefly presented in Section III. This is followed in Section IV by a discussion on how Nepal is faring in terms of progress in the financial inclusion front together with an assessment of some financial indicators drawn from different sources. Major policies are then reviewed before putting forward some prescriptions for advancing financial inclusion. Section V concludes.

II. METHODOLOGY

Being non-technical, this policy paper is basically descriptive and analytical in nature and based on a number of policy models and provisions formulated in recent years for promoting financial inclusion in Nepal. Secondary data is used, drawn primarily from Department of Cooperatives and different departments of Nepal Rastra Bank (NRB), namely Banks and Financial Institutions Regulation Department, Microfinance Promotion and Supervision Department and Research Department. Financial inclusion data is also extracted from sources such as the International Monetary Fund, United Nations Capital Development Fund (UNCDF), World Bank and World Economic Forum, among others.

III. LITERATURE REVIEW

Literature reveals that there exists no universal definition of financial inclusion. In general, financial inclusion denotes access to finance and financial services for all in a fair, transparent and equitable manner at an affordable cost (Sarma, 2008). According to Fuller and Mellor (2008), financial inclusion refers to the desire to develop 'alternative', welfare-oriented, reliable, affordable and accessible financial services for the entire population. Alpana (2007), however, considers inclusion as a market-driven solution for poverty alleviation. All in all, financial inclusion is a desired outcome as it can assist poor people in accessing financial services at a reasonable cost.

Better access to credit by the poor helps them to pull themselves out of poverty by investing in human capital and microenterprises, thus lowering aggregate poverty (Banerjee and Newman 1993; Aghion and Bolton 1997). Access to financial services is assumed to permit households to smooth consumption. 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. Different financial services often allow for the attainment of the same goal, though with different degrees of efficiency. For instance, Collins et al. (2009) argue that savings and credit are often viewed as substitutes for poor people, with the former signifying many small payments upfront with one large pay-out at the end and latter having one large pay-out in the beginning and many small payments later on.

Though financial inclusion has become a topical issue on the global policy agenda for sustainable development, economic literature on financial inclusion is still incomplete. Most researchers have probed into the appropriate measures of financial inclusion at both the household and country levels. While some papers focused on the role of financial access in lowering poverty and income inequality (Park and Mercado, Jr, 2015), other papers have dealt with varying levels of financial inclusion both in advanced and emerging economies.

It is generally agreed that financial inclusion need to cover four types of financial services—savings, payment, credit, and insurance (Independent Evaluation Group, 2014). Likewise, these services should be framed in a way accessible to traditionally excluded groups, including to the poor, women, minority groups and those difficult to reach, for instance, rural dwellers. Moreover, provision of these services need to satisfy adequate levels of quality, that is, need to be affordable, available, and stable and fulfill minimum standards of consumer protection. Lastly, these services should be provided by a host of institutions with respect to choice and competition.

However, the gaps in access, use, and quality of savings accounts in financial institutions, and in the availability of credit and insurance products among different segments of the economy are still large (World Bank, 2014). Globally, 2 billion adults remain unbanked. South Asia and East Asia and the Pacific together account for more than half the world's unbanked adults. South Asia, home to about 625 million adults without an account, has about 31 percent of the global total; East Asia and the Pacific, with 490 million unbanked adults, accounts for about 24 percent. Women make up 55 percent of the world's unbanked adults (Demirguc-Kunt et. al, 2015). Sahay et al. (2015) also find large gaps in access to financial services between the rich and poor, urban and rural dwellers, and men and women.

Growth from financial development is inclusive only if the poor have access. Despite having a deeper financial sector than other developing regions, Asia lags its peers in meeting the financing needs of households and firms (ADB, 2015). Asian firms lack bank services, especially credit. Just 84 percent of firms in developing Asia have a checking or savings account, which is comparable to Africa but falls behind Latin America's 89 percent and emerging Europe's 92 percent. Likewise, only 33 percent of firms in developing Asia have a line of credit or loan from a financial institution—lower than Latin America's 54 percent and emerging Europe's 41 percent.²

While financial inclusion calls for bringing the entire financial sector to serve low income and rural households, the most promising development in decades has been digital payments via mobile phones (Beck, 2015). Digital payments reduce costs for both payer and payee, lowers risks, and increases privacy. It also has advantages for governments as

² A range of barriers impedes Asian household and corporate access to finance. Household surveys find that account fees, difficult geographic access, and stiff documentation requirements are major hindrances. For Asian firms, the major deterrents to borrowing are unfavorable interest rates, complex application procedures, and high collateral requirements. For details on the barriers, see ADB (2015).

it increases the transparency of payment flows. Muralidharan et al. (2014) show that shifting from manual cash-out to digital payments via smart cards of social security pension in Andhra Pradesh lowers the degree of leakage between government payments and beneficiary receipts considerably. Still, though mobile money can transform financial inclusion, the benefits of this technology are not trickling down to the poor in most of the least developed countries.

With respect to impact of financial inclusion on economic growth by supporting localized development, this generally happens via providing people with access to financial services, loans, credit and insurance, thereby allowing them to engage in gainful economic activity. In turn, this empowers people to provide for themselves and their families, and to save and invest their earnings. Oji (2015) explains that empowering the financially excluded through the provision of suitable financial products opens up and increases the potential for local economic development. With the appropriate support structures, people can establish small enterprises while employing others to generate their own income and carry out financial transactions, which are necessary to grow and sustain local economies.

Little information exists about the macroeconomic implications of financial inclusion. Sahay et al. (2015) showed that household's access to finance has a strong positive relationship with growth. They further demonstrated that the relationship between depth and growth is bell-shaped, denoting that the returns to growth drops with higher depth beyond a certain point. By employing a general equilibrium model, Dabla-Norris et al. (2015) illustrate how reducing monitoring costs, loosening collateral requirements and subsequently increasing firms' access to credit would raise growth. Hariharan and Marktanner (2012), while examining the full impact of financial inclusion on economic growth potential, estimate that a 10 percentage point increase in financial inclusion (measured as an account with a formal financial institution as defined in the Global Findex Survey) could give rise to an increase in income per worker by 1.3 percent on average, with increases in financial inclusion resulting in improvements in total factor productivity and capital per worker.

Greater financial inclusion may also lead to an improvement in the effectiveness of both monetary and fiscal policy.³ Fiscal effectiveness is enhanced both through raising the tax revenue base and through greater effectiveness of welfare benefit and transfer schemes. This is particularly important in many developing countries where country governance is generally weak and the benefits of welfare and subsidy schemes often remain with bureaucrats or middle-men. Better governance works to lower income inequality in an economy. 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.

Financial inclusion also has important ramifications for monetary and financial stability (Mehrotra and Yetman, 2015). Increased financial inclusion alters the behavior of firms and consumers, subsequently influencing the efficacy of monetary policy. For instance,

³ The impact of financial inclusion on monetary and fiscal policy is elaborated in Khan (2012).

greater inclusion should make interest rates more effective as a policy instrument and it may support central banks' attempts to maintain price stability. Financial stability also may be impacted as the composition of savers and borrowers is changed. While on the one hand a broader base of depositors and more diversified lending may contribute to financial stability, on the other, greater financial access may amplify financial risks if it arises from rapid credit growth or the expansion of relatively unregulated parts of the financial system.

On access to basic payments and savings, the microeconomic evidence on benefits, particularly among poor households, is quite supportive (World Bank, 2014). For firms, particularly small firms that encounter greater constraints, access to finance is linked with innovation, employment generation, and growth.

The foregoing literature review demonstrates that 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. It also shows that small businesses benefit from access to credit while savings help households smooth consumption. Overall, when financial inclusion is accorded a major role in the government's economic plan, the country becomes more successful in increasing access to reach the many unbanked and underserved people as well as in ensuring equitable economic opportunities. However, for all of this to materialize, practical and effective policies do matter.

IV. FINANCIAL INCLUSION IN NEPAL

In Nepal, a number of financial outreach-related policy initiatives are underway together with a long-term development strategy under the formulation process with priority accorded to helping the country to graduate from a least developed country status by 2022 as well to attain the UN Sustainable Development Goals and become a middle-income country by 2030.⁴ Financial inclusion seems appropriate to address this objective as it provides the opportunity for the country to effectively collaborate with its bilateral and multilateral partners to make its 2030 vision a reality.

The Strategic Plan (2012-2016) of Nepal Rastra Bank (NRB) was formulated based on seven strategic pillars, financial sector stability being one of them under which enhancing financial inclusion has been identified as a strategic priority. Similarly, the Monetary Policy of 2016/17 has also focused on deepening financial inclusion through enhancing financial literacy as well as access to finance. Likewise, the Banks and Financial Institutions Act (BAFIA), which governs all activities of banks in the country, is a central path for advancing financial inclusion. It has been made compulsory by the NRB, under its deprived sector lending directive, for class A, B and C class financial institutions to make available low-cost funds to micro finance institutions (MFIs), thereby facilitating access of financial services to the underserved areas.

⁴ The graduation from a least developed country status by 2022 has been highlighted in the country's *Thirteenth Plan* which also lays emphasis on the development of a sound banking and financial system in order to attain the Plan's priority sector objectives.

With regard to the players in the financial sector, there are four classes of financial institutions licensed by the NRB, namely commercial banks (A class), development banks (B class), finance companies (C class) and MFIs (D class). The number of commercial banks, development banks, finance companies and MFIs aggregated 28, 67, 41 and 42 respectively at mid-July 2016.

Financial access has been rising with the increase in branches of financial institutions. As at mid-July 2016, the number of branches of commercial banks stood at 1869, followed by 1,378 branches of MFIs, 852 branches of development banks and 175 branches of finance companies. The population per branch of financial institution remained at 6,562 at mid-July 2016.⁵ However, despite the rise in number of BFIs and their branches, the financial institutions are still primarily scattered around the urban or semi-urban areas where geographical access is fairly simple. With respect to regional distribution, as at mid-July 2016, the major branches of BFIs are situated in the Central Development Region (45.5 percent), followed by Western Development Region (24.0 percent) and Eastern Development Region (16.4 percent).⁶ Despite continuous efforts from the NRB in increasing the outreach of financial services in remote areas, the progress has been quite dismal with respect to the branch expansion in Mid-Western Development Region (9.2 percent) and Far Western Development Region (4.9 percent).

In Nepal, branchless banking has been promoted taking into consideration the payment needs of people who are excluded from access to the financial system. Similarly, mobile phone based payment systems have been encouraged so as to facilitate payments at merchandise outlets. As at mid-July 2016, branchless banking centers aggregated 812. Likewise, the total number of ATM terminals increased to 1,908 in mid-July 2016 from 1,721 in mid-July 2015. The total number of debit cards and credit cards issued also increased to 4,657,125 and 52,014 respectively in mid-July 2016 from 4,531,787 and 43,895 in mid-July 2015. This upsurge denotes that the banking system is being more automated.

Financial Inclusion Indicators: A Review

According to a survey carried out by UNCDF in late 2014, 61 percent of Nepalese adults are formally banked while 21 percent use only informal channels and 18 percent remain financially excluded.⁷ Moreover, 52 percent of the banked are men while 48 percent are women. A summary of the major survey findings is depicted in Box 1.

⁵ This excludes the FINGOs and cooperatives. The data are drawn from Banks and Financial Institutions Regulations Department (2016).

⁶ Data only relate to the branches of A, B, and C class financial institutions.

⁷ Conducted in late 2014, the survey was based on 4,014 samples of the adult population in Nepal, aged 18 years and above, across 70 districts covering the terai, hills and mountain. The survey was developed on the basis of the globally recognized FinScope methodology. This survey is the initial findings of UNCDF's Making Access to Finance Possible (MAP) Programme in Nepal.

. Box 1: Highlights from FINSCOPE Survey

- 61 percent of adults have access to formal financial services (40 percent formally banked and 21 percent using ‘other formal’ products).
- 21 percent of adults use only informal financial services.
- 18 percent of Nepalese adults are financially excluded, that is, claim to use neither formal nor informal financial providers.
- 52 percent of the banked are men and 48 percent are women.
- 22 percent of adults claim to belong to a cooperative—of all adults 19 percent claim saving and 9 percent claim borrowing from cooperatives.
- 29 percent of adults claim to belong to a savings group, 18 percent claim to be saving with their groups and 8 percent claim to obtain credit from their savings group.
- 57 percent of adults claim to save money.
- 46 percent of adults claim to borrow.
- 34 percent of adults claim to send or receive receive remittances and 27 percent remit formally.
- The top five sources for taking loans are: 1) money lenders in the community (21 percent), 2) banks (including MFIs) (10 percent), 3) cooperatives (9 percent), 4) saving groups (8 percent), and 5) family/friends (8 percent).
- 28 percent of adults claim to be aware of insurance, while only 11 percent claim to have a form of insurance.

Source: UNCDF (2015).

There are also a number of other sources that have computed financial inclusion indicators for Nepal. According to World Bank (2015), 25.3 percent of adults in Nepal hold an account at a formal financial institution. However, a study by Demirguc-Kunt et al. (2015) reveal that 33.8 percent of the adults (age of 15+) have bank accounts in Nepal, 6.7 percent have debit card, and ATM is the principal mode of withdrawal for 13.9 percent of the adults. Likewise, 16.4 percent of the adults saved at a financial institution while 11.9 percent borrowed from a financial institution. Similarly, 15.4 percent of the population use the internet and mobile cellular subscriptions (per 100 people) stand at 76.8 (World Bank, 2016).

The IMF's Financial Access Survey 2016 reveals that in 2015, the number of ATMs per 100,000 adults stood at about 9.0, loan accounts with commercial banks per 1,000 adults number 36.6, the number of mobile banking/agent outlets per 100,000 adults stood at 2.6 and the number of mobile money accounts per 1,000 adults stood at 55.6 (IMF, 2016). A summary of some of the indicators is depicted in Table 1.

Table 1: Some Financial Inclusion Indicators

Indicator	Data
ATMs per 100, 000 adults	9.0
Possession of debit card (% age 15+)	6.7
Mobile cellular subscriptions (per 100 people)	81.9
Mobile banking/agent outlets (registered per 100,000 adults)	2.6
Mobile money accounts (active per 1,000 adults)	55.6
Individuals using the internet (% of population)	15.4
Borrowed from a financial institution (% age 15+)	11.9
Saved at a financial institution (% age 15+)	16.4

Sources: World Bank (2015), World Bank (2016), Demircuc-Kunt et al. (2015), and IMF (2016).

According to World Economic Forum (2016), out of 138 economies, Nepal is ranked at 65th position in terms of ease of access to loans and 84th position with respect to affordability of financial services.

Though some discrepancies exist between the various sources with respect to the indicators of financial inclusion, they all divulge that large parts of the country are still excluded from the formal financial sector. The majority of banks and financial institutions have been found to be clustered around accessible urban and semi-urban areas. As formal financial services in Nepal have not been fully successful in reaching to the poor, marginalized and deprived segment of population, the overriding issue for enhancing financial inclusion is how to penetrate into this segment of the population.

Financial Inclusion Policies

After realizing the importance of financial inclusion policy for the country, NRB in coordination with the Government of Nepal, had introduced a number of policy models for enhancing financial inclusion in the country.⁸ These included the Grameen Bank Model, the Wholesale Micro Finance Model, the Directed Lending Model, Project-Based Micro Credit Model, the FINGOs Model and the Cooperative Model.

With regard to the Grameen Bank Model, developed in Bangladesh by Prof. Muhammad Yunus and based on group solidarity mechanism where credit is linked to savings. MFIs licensed by the NRB have incorporated this model to cater financial services to the poor and deprived people, especially in rural areas. As of mid-July 2016, there were a total of 42 MFIs operating in Nepal with total number of branches standing at 1,378 and total members of 1.90 million.

Wholesale Microfinance Model was introduced in Nepal with the establishment of the Rural Self-Reliance Fund (RSRF) in 1991 through the joint initiation of the Government and NRB to provide credit to the rural poor for income generating activities in order to improve their living standard through NGOs. The other wholesale lending institutions include Rural Microfinance Development Center, Small Farmer Development Bank Ltd.,

⁸ Neupane (2014) provides a chronological review of the policy measures for promoting financial inclusion.

First Microfinance Development Bank and RSDC Micro Finance Development Bank that manage their funds from other BFIs (A, B or C class) with respect to deprived sector lending or take loan from other institutions and then provide wholesale credit to MFIs and/or cooperatives for further lending to individual clients as micro credit.

With respect to Directed Lending Model, it was in the early 1970s that the priority sector lending model was introduced when the banks were directed to lend 5 percent of their total deposits to small sectors. This was renamed as 'Intensive Banking Program' in 1981 and banks were directed to lend at least 12 percent of their outstanding credit to agriculture, cottage industry and service sectors. This program was phased out in 2007. NRB introduced the Deprived Sector Credit Program in 1991 under which the BFIs (A, B and C class) were required to lend a specified portion of total outstanding loan to deprived sector.⁹ Presently, commercial banks, development banks and finance companies are required to lend at least 5.0 percent, 4.5 percent and 4.0 percent of their outstanding loans respectively to deprived sector either directly or through any other MFIs.¹⁰

Under the Project-based Micro-credit Model, a large number of external donor agencies have been providing technical and financial assistance to enhance the rural financing activities in Nepal. These include IDA, ADB, UNDP, UNICEF, UNIFEM, EU, IFAD, USAID, CIDA, GIZ, DFID, and UNCDF. Some of the major donor-funded projects carried out in Nepal in the past include Production Credit for Rural Women (PCRW), Micro Credit Project of Women (MCPW) and Third Livestock Development Project (TLDP). Some projects such as Raising Income of Small and Medium Farmers Project (RISMFP), UNNATI Access to Finance Project (UNNATI-A2F), Mobile Money for the Poor (MM4P) and Making Access Possible (MAP) are currently ongoing. These projects have focused on poverty alleviation and access to finance in rural areas.

With regard to the FINGOs Model, though there are many unregistered NGOs engaged in either microfinance activities or social and community development activities, there are also some financial NGOs (FINGOs) that have been permitted by NRB to conduct limited banking activities. With the promulgation of Financial Intermediary Act-1998, a broader scope was created for NGOs to function as financial intermediaries as well. These FINGOs, numbering 26, help promote credit activities in rural areas and mobilize small savings. However, they have been directed by NRB to transform themselves into MFIs.

Under the Cooperative Model, there are 32,663 cooperatives operating in the country. Out of these, some 13,460 are savings and credit cooperatives (SACCOs), some 4,031 are

⁹ Deprived sector lending refers to small loans that are provided to the low income people for small projects in an effort to uplift their socio-economic status.

¹⁰ However, as per *Monetary Policy of 2016/17*, though the ratio of loan to be extended by the commercial banks to the deprived sector has remained the same at 5 percent, the commercial banks are required to invest minimum 2 percent of the loan directly.

multipurpose and the remaining are specific product/objective-based cooperatives.¹¹ Out of the total SACCOs, 15 of them are also permitted to conduct limited banking activities by NRB. There also exists one cooperative bank that provides wholesale loan to the other cooperatives.

The NRB also undertook an array of other policy measures to ensure reliable and affordable financial services to the poor including liberal licensing policy for MFIs, requirements for BFIs (A, B, and C Class) to allocate certain proportion of their credit for investment in the productive sector, special refinance facility to cottage and small industries, directives on consumer protection, and directives on branchless banking and mobile banking services, among others. Details of some of recent policy provisions for enhancing financial inclusion are examined below:

- The NRB provides direct financial support to the banks and financial institutions where the number of banking units is low. BFIs (A class and national level B class) opening a branch among the specified 14 remote district headquarters would get Rs. 5 million interest free loan and Rs. 10 million, if established outside the district headquarters. MFIs opening a branch in the specified 22 remote districts with low banking access would receive Rs. 3 million interest free loan.
- In its Monetary Policy of 2015/16, the NRB made a provision of special refinance facility at 1 percent interest with the aim of encouraging BFIs (A, B, and C class) to extend loans to agriculture and small business-based income generating activities in poverty stricken areas of the country.
- As per Monetary Policy of 2016/17, and taking into account the study report of e-mapping, steps would be initiated by the NRB to devise relevant policies relating to financial access, among others. While new applications for licenses are postponed until such policies are formulated, the current licensing policy would prevail for MFIs with head office and working area located in the districts with low access to financial services.
- With regard to consumer protection, NRB has instructed the MFIs to develop a separate Client Protection Fund for the institutional development and welfare of the borrowers. Under the directive, the MFIs are required to allocate 1 percent of their net profits to the fund and are also required to allocate another 25 percent of the dividends if the dividend distribution exceeds 20 percent of their profit.
- For enhancing financial access and inclusion, the Government of Nepal in its Budget for 2015/16 had announced a policy encouraging for opening a bank account for each household. In line with this, NRB is introducing “one account in one household” campaign in the near future.
- Financial literacy programs are being conducted through audio-visual and print media. The final draft of the National Financial Literacy Policy has been submitted to the Government for approval. The financial literacy campaign would focus on

¹¹ Data on cooperatives is as of mid-July 2015 and obtained from Department of Cooperatives. The total number of cooperative members stood at 5.1 million.

spreading awareness about banking and non-banking institutions and also educate communities about the informal financial sector including dhukuti and hundi. The policy aims to enhance the inflow of remittances through the banking sector and utilize them productively. Two types of structures (a High Level National Financial Literacy Council led by the Finance Minister and a Financial Literacy Committee led by the Deputy Governor of Nepal Rastra Bank) have been proposed to implement the policy.

- The Financial Sector Development Strategy (FSDS), covering the period from 2016/17 to 2020/21, has recently been approved by the Government of Nepal. The FSDS, in which financial access and inclusion serve as a pillar of the banking system, lays emphasis on certain techniques for increasing financial outreach. These include the following: a) augmenting availability of BFI services in rural and remote areas; b) developing proper policies for expanding financial access and inclusion; c) improving institutional arrangements for broadening financial access; d) building up the regulatory and supervisory framework for MFIs; e) arousing public awareness through financial education; and f) promoting consumer protection with respect to the utilization of financial services and products. To implement the FSDS, an Implementation Committee has been proposed that will be headed by the NRB Governor with the heads of other financial regulatory agencies as members.

Prescriptions

Though many policies and programs have been formulated for enhancing financial inclusion, this has not happened to the desired extent. As a number of villages are still unbanked, are located far from the district capital, and are thinly concentrated with scattered dwellings, it is a difficult task to render basic facilities including electricity, telecommunication, and banks in these places. Hence, there is still a risk of exclusion of the very poor and dependent population arising from the country's geography.

Moving forward, a number of suggestions can be made for promoting financial inclusion. These include the following:

(a) Promotion of Financial Literacy Programs

Financial literacy remains the key to beneficial and continuous linkage with formal financial system. It must be promoted for financial inclusion to be sustainable, with people saving, obtaining loans, investing and insuring themselves and their families against financial shocks. Financial education requires a multi-stakeholder approach to drive costs down for greater sustainability and to reach all pockets of society. Likewise, it deems crucial to educate the people, especially the rural population, on the significance of saving. For this, financial literacy camps could be organized regularly in collaboration with the district development committee or village development committee with the aim of familiarizing the various financial products and the advantages of having an account with a formal financial institution. Likewise, educating people about financial risks can prevent them from investing in dubious schemes. Similarly, financial literacy is essentially linked to consumer protection. With more knowledge people are less likely to fall victim to unscrupulous moneylenders, or financial service providers who might be

offering inappropriate products, with exorbitant interest rates and no transparency. Still, more research and evaluation is required to further explore the relationship between financial literacy and financial inclusion, and to ascertain the impact of financial education initiatives on financial inclusion.

(b) Bank Account Usage

It is often noticed that mere opening a bank account is claimed as achieving the target of financial inclusion. Many empirical studies and usage analysis reveal that after opening bank accounts, hardly any transactions take place in such accounts. This creates a dilemma as usage is a crucial component for the success of financial inclusion. Hence, policymakers need to accord more attention to usage when formulating the financial inclusion strategy. The stress given to usage is essential since diverse portfolios make the poor less vulnerable to the unanticipated events (Morawczynski et. al, 2010). The socio-economic goals, which are the stimulus for the financial inclusion drive, will not be attained if the banked poor are not encouraged to avail themselves of the opportunities that access imparts. Likewise, more usage can also result in other important outcomes such as increased savings balances over time and increased access to other vital financial services including loans. So in the case of Nepal, while introducing the "one account in one household" campaign and implementing it, its uses must also be properly disseminated. In this respect, financial education will play a central role.

(c) Mobile Banking and Digital Financial Services

Technology plays a pivotal role in the process of inclusion. In Nepal, the potential of mobile banking has not been tapped to the extent desired. With deeper penetration of mobile technology, mobile banking has great prospects of increasing accessibility of financial services to the poor, particularly in remote areas where bank branches cannot be opened owing to infrastructure bottlenecks. Likewise, a promising technique to expand financial inclusion among the unbanked is to digitize payments by moving cash payments into accounts.^{12,13} It can improve the efficiency of making payments by increasing the speed of payments and by lowering the cost of disbursing and receiving them. Digital financial services can make life easier for customers by allowing them to transact locally in tiny amounts and better manage their uneven income and expenses. Digital channels reduce transaction costs, increase transparency, and raise access to formal financial

¹² "Digital financial inclusion" can be defined as digital access to and use of formal financial services by excluded and underserved populations. Such services should be suited to the customers' needs and delivered responsibly, at a cost both affordable to customers and sustainable for providers. For details, see CGAP (2015).

¹³ In Nepal, a few initiatives such as Sakchyam's Branchless Banking Initiatives and UNCDF's Mobile Money for the Poor (MM4P) are underway for accelerating the pace of digital financial services. Likewise, NRB, through its *Monetary Policy of 2015/16*, accorded due priority to the expansion of branchless banking and mobile banking services in the geographical region with low financial access. Analogously, the government announced in its Budget for 2016/17 to channelize government to people (G2P) payments including pensions and other social security allowances through digital channels after making necessary arrangements.

services that help people break the cycle of poverty and drive inclusive economic growth. In Nepal's case, it is possible for digital financial inclusion to become a game changer for unserved and under-served low-income households as well as micro- and small enterprises in the country.

(d) Redesigning Business Strategies

Financial institutions need to redesign their business strategies to incorporate specific plans for promoting access of their services to low-income group treating it both as a business opportunity as well as a corporate social responsibility in order to promote financial inclusion. They need to use all available resources including technology and expertise for the cause of financial inclusion and they should think access to finance outside the conventional thinking and in an innovative way.

(e) Formulation of National Financial Inclusion Strategy

Formulation of a national financial inclusion strategy could be an effective means to prioritize goals, balance the development of different financial services required to attain financial inclusion and align the roles and expectations of regulators. A national financial inclusion strategy can help augment the level of awareness on issues of financial inclusion, build up trust among various stakeholders, determine the best modalities for coordination, and ensure relevance at the national level. This is a detailed public document developed through a broad-based consultative process with private and public sector stakeholders associated with financial sector development to systematically speed up the level of financial inclusion.

(f) Implementation of a Financial Inclusion Roadmap

A roadmap serves as a guide to financial inclusion initiatives in the country. In this regard, UNCDF (2016) released the Nepal Financial Inclusion Roadmap (2017–2022) which puts forward a policy target of raising formal financial inclusion in Nepal from 60 percent to 75 percent by 2022, and reducing the excluded from 18 percent to 3 percent so as to generate economic empowerment by the following measures: 1) unlocking constrained credit and savings markets; 2) improving the payments system; 3) bolstering risk-mitigation capabilities; 4) enhancing and leveraging locally based financial service providers; 5) enhancing financial inclusion support in the national governance; and 6) strengthening consumer empowerment, protection and education.^{14,15}

¹⁴ Details of the roadmap are given in UNCDF (2016).

¹⁵ The success of the implementation of the roadmap is governed by certain conditions: a) stable political situation; b) timely approval of primary financial sector policies and proposed amendments to key policies and acts; c) improved infrastructure and Internet connectivity; and d) improved education infrastructure and literacy levels, among others.

The implementation of the proposed recommendations is expected to broaden financial services and directly improve household welfare through a) the introduction of pertinent products with respect to key consumer needs, b) the employment of sustainable business models and c) the setting up of partnerships that effectively serve the various target markets. The implementation of the roadmap is also anticipated to support economic growth and assist in the development of human capital.

(g) Special Role for MFIs

MFIs could play a paramount role in facilitating inclusion, since they are uniquely positioned in reaching out to the rural poor. Many of them operate in a limited geographical area, have a greater understanding of the issues specific to the rural poor, enjoy greater acceptability amongst the rural poor and have flexibility in operations providing a level of comfort to their clientele. Moreover, MFIs are often better positioned than banks to offer money transfer services to remittance recipients in remote rural areas with low-cost transfer products. They can support clients' family members in developing micro enterprises through entrepreneurship development by extending access to finance and enabling them to meet the capital needs of their enterprises.

(h) Adequate and Reliable Data

Dealing with financial inclusion demands adequate data that is important for financial service providers as they can modify their offering of financial services and products only if they have a clear picture of where the potential customers are and what they require. This is a major condition for ensuring that customized financial products can be designed for specific categories of consumers. In a similar vein, authorities wishing to reduce financial exclusion have to depend on good data, not only to calibrate their various policy initiatives *ex ante*, but also to ensure that their outcomes can be evaluated *ex post* and the policy modified subsequently.

Similarly, monitoring progress and measuring outcomes of financial inclusion policy reforms are crucial components of any financial inclusion initiative. To monitor progress in achieving more inclusive financial systems as well as to measure their impact, reliable and complete data that encapsulate various dimensions of financial inclusion are required for evidence-based policymaking.

V. CONCLUSION

The primary aim of financial inclusion - ensuring that every individual has access to quality, affordable financial services - has become an increasing priority worldwide. Thus, many governments in developing economies are promoting financial inclusion as a policy goal. However, ensuring financial inclusion is an arduous task as addressing it requires a holistic approach encompassing effective approaches to provision of affordable credit services, awareness raising, financial education, saving mobilization, and research and development, among others.

While financial inclusion may have become a general phenomenon, its nature, form and challenges differ among countries and as such cannot be addressed by a single product or

“one size fit all” approach. In Nepal's case, financial inclusion is not only a choice but also a necessity for economic growth. Hence, it is likely to continue to remain a leading priority on the government’s agenda. It is key to Nepal's future because it empowers the poor, promotes small businesses and promotes inclusive growth. Still, for sustained and inclusive development to thrive, innovation is a must for ensuring that appropriate financial services and instruments are incorporated for the benefit of the poor and other disadvantaged groups.

Though gradual progress is being made, critical challenges of low financial literacy, inadequate infrastructural facilities and lack of technology-based facilities, among others, have limited the achievement of significant expansion in the level of financial inclusion. By implementing appropriate policies relating to financial literacy, bank account usage, digital financial services, Financial Inclusion Roadmap, as well as according special role to MFIs, among others, the Government and NRB can make some inroads into enhancing financial inclusion.

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