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Changing Dimension of Financial Inclusion in Nepal: A Comparative Analysis

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ABSTRACT

Financial inclusion is essential for inclusive growth that is necessary for reducing poverty and inequality in the economy. This paper aims to analyze changes in various dimensions of financial inclusion in Nepal over time and compare it with other South Asian countries based on the available secondary data. With various policy initiatives taken in the past, financial inclusion in Nepal has been improving satisfactorily over time. However, Nepal has been far behind compared to some South Asian countries like Sri Lanka and India in many aspects of financial inclusion. Nepal has inadequate and unequal access and very low usage, particularly use of credit, indicating a long way ahead to make financial system more inclusive. By utilizing modern technology and adopting as well as implementing inclusive policies, access to finance has to be increased inclusively. Further, by creating awareness and increasing the benefits, the usage of formal financial services should be increased for meaningful financial inclusion.

JEL Classification: G21, G28, O16

Key Words: Financial Inclusion, Financial Services, Financial Institutions, South Asian Countries

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Comments and Suggestions are welcomed.

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I. INTRODUCTION

Efficient and well-functioning financial systems are very essential to channelize funds to the most productive usages and manage risks; thereby promoting economic growth and reducing income inequality and poverty (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, p22). Hence, there should be financial inclusion. However, in many countries not all people have been included in the financial system, and so is the situation in Nepal as well. Therefore, expanding financial inclusion has been a policy priority for many countries.

Financial inclusion is also needed to achieve the Sustainable Development Goals (SDG). 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, 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) and Asian Development Bank (ADB) 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. Alliance for Financial Inclusion (AFI), a multilateral institution, was established in January 2008 solely to promote financial inclusion across the globe. 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 preparing 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), Tissot and Gadanecz (2017). However, a few studies such as Dhungana and Kumar (2015) and Pant (2016) demonstrate the status of financial inclusion in Nepal to some extent. But comparative analyses over time and comparison with neighbouring South Asian countries have not been found yet.

In this context, this paper aims to assess the progress in financial inclusion in Nepal overtime as well as compare it with that in other South Asian countries namely Afghanistan, Bangladesh, India, Pakistan, and Sri Lanka. This assessment will be useful to know the comparative status and 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.

Structure of this paper is as follow. Section 2 presents the conceptual framework of financial inclusion covering various aspects of it and Section 3 highlights the data and methodology used for analysis. Section 4 and 5 presents the changing situation of financial inclusion in Nepal and comparison with South Asian countries. Such an assessment helps us to understand progress in financial inclusion as of now as well as relative to neighbouring countries. Section 6 lists the current policy provisions and recent development related to financial inclusion in Nepal. Finally, the paper ends with conclusions and some policy recommendations in the last section 7.

II. CONCEPTUAL FRAMEWORK OF FINANCIAL INCLUSION

2.1 Definition

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) define financial exclusion as referring to those processes that serve to prevent certain social groups and individuals from gaining access to the formal financial system. According to Conroy (2005), being specific, financial exclusion is a process that prevents poor and disadvantaged social groups from gaining access to the formal financial systems of their countries. 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).

Opposite to financial exclusion, Government Committee on financial inclusion in India defines financial inclusion 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, 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, p22). According to the BIS (2015), financial inclusion covers three dimensions: accessibility, usage and quality of financial services to all kind of people. The 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"(p3).

2.2 Importance

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 microenterprises. 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 ameliorating 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 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 Nature 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.

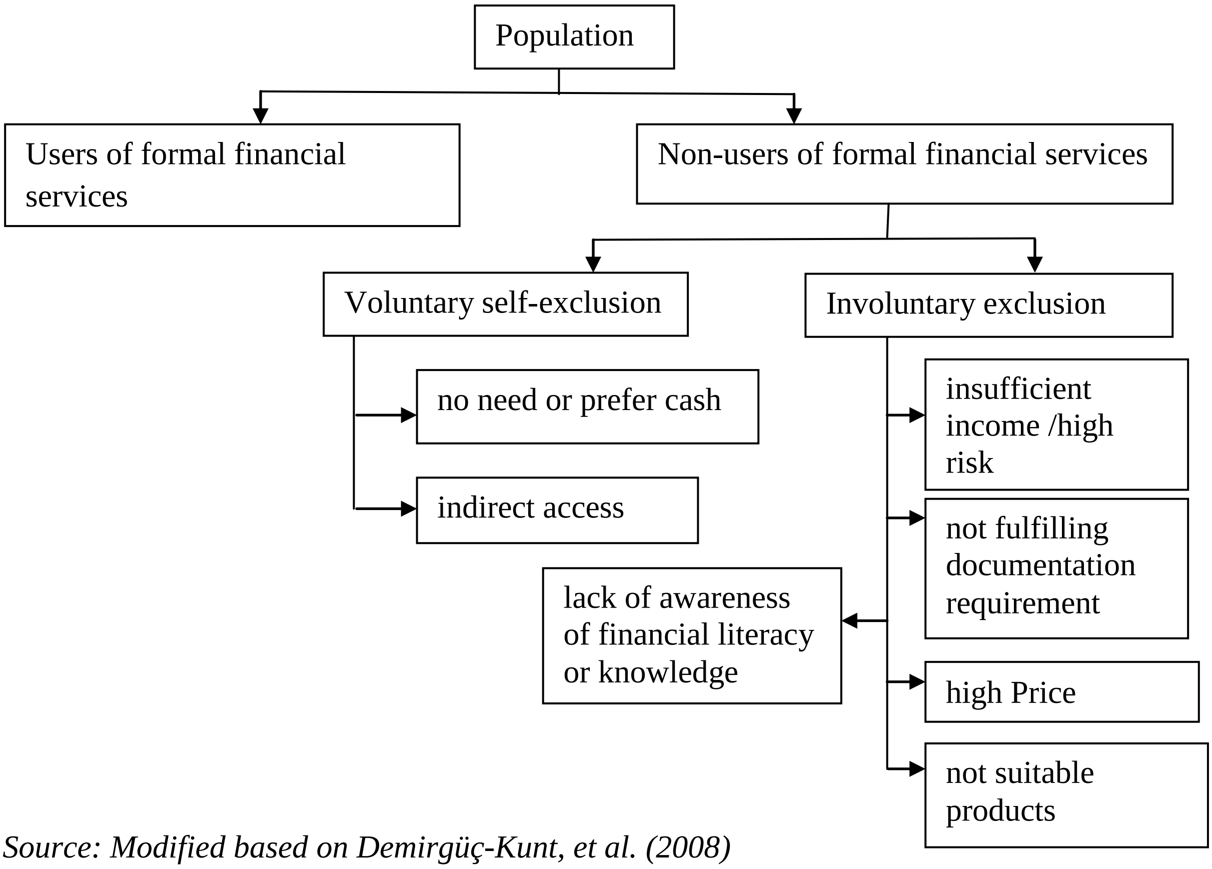
Table 1: Types of Financial inclusion

S.N.	Types of Financial Exclusion	Explanation
1	access exclusion	due to geography
2	condition exclusion	due to conditions that are inappropriate for some people
3	price exclusion	due to non-affordability of financial services
4	marketing exclusion	due to targeted marketing and sales of financial products
5	self-exclusion	due to "fear of refusal or due to psychological barriers

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.

Figure 1: Voluntary and Involuntary Financial Exclusion



Source: Modified based on Demirgüç-Kunt, et al. (2008)

Several factors may result in involuntary exclusion in using financial services, which is more important to focus on. As shown in Figure1, 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, p15).

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.

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, 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, 16). Thus, we need demand side information on usage of financial services as well as preferences to assess the situation of financial inclusion.

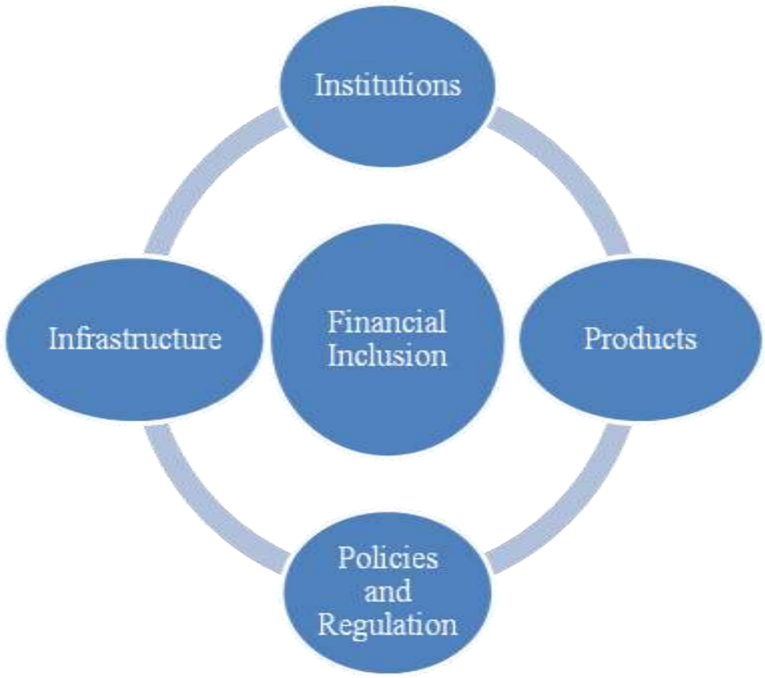
Demand side information on financial inclusion can only be obtained from households or firms level surveys by determining core indicators. These types of survey can only be done in a certain interval because of time and costs. Hence, demand side information of financial inclusion cannot be available 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 recently been developed to examine the situation of financial inclusion in any country (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 (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).

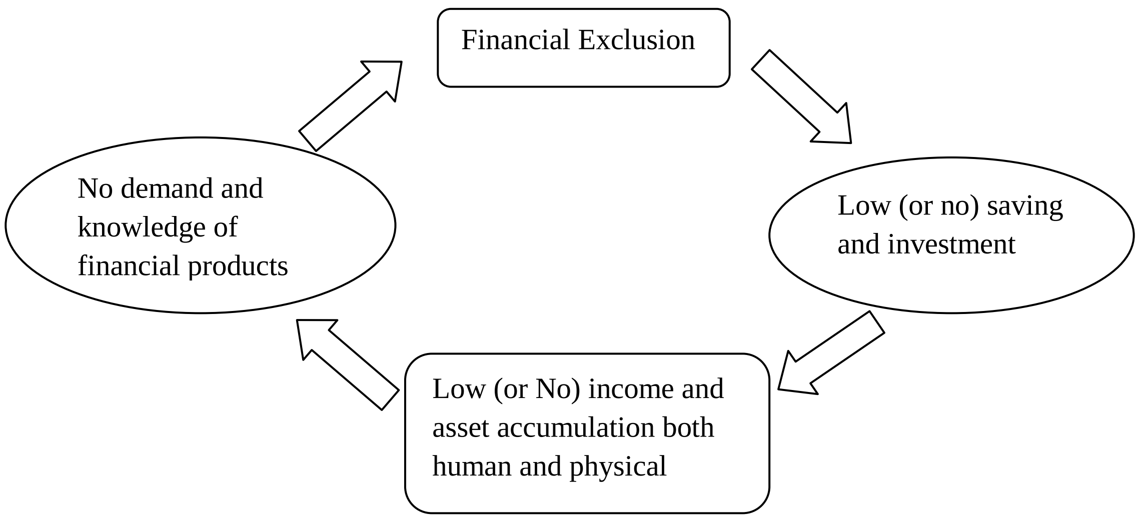
Figure 2: Drivers of Financial Inclusion



Source: 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



Source: Author's design

2.6 Ways of Increasing Financial Inclusion

G20 Financial Inclusion Experts Group came up with nine principles for enhancing innovative financial inclusions as shown in Table 2 based on the experience of G20 countries (G20, 2010). Application of these principles helps in increasing financial inclusion in any economy and can break the vicious circle of financial exclusion as discussed above. The World Bank (2014) further suggests for using technology, product design and business models, and financial literacy and business training for including people into formal financial system.

Table 2: Principles for Innovative Financial Inclusion

S.N	Principles	Explanation
1	Leadership	Cultivate a broad-based government commitment to financial inclusion to help alleviate poverty
2	Diversity	Implement policy approaches that promote competition and provide market-based incentives for delivery of sustainable financial access and usage of a broad range of affordable services (savings, credit, payments and transfers, insurance) as well as a diversity of service providers
3	Innovation	Promote technological and institutional innovation as a means to expand financial system access and usage, including by addressing infrastructure weaknesses
4	Protection	Encourage a comprehensive approach to consumer protection that recognises the roles of government, providers and consumers
5	Empowerment	Develop financial literacy and financial capability
6	Cooperation	Create an institutional environment with clear lines of accountability and co-ordination within government; and also encourage partnerships and direct consultation across government, business and other stakeholders.
7	Knowledge	Utilize improved data to make evidence based policy, measure progress, and consider an incremental "test and learn" approach acceptable to both regulator and service provider.
8	Proportionality	Build a policy and regulatory framework that is proportionate with the risks and benefits involved in such innovative products and services and is based on an understanding of the gaps and barriers in existing regulation.
9	Framework	Consider the following in the regulatory framework, reflecting international standards, national circumstances and support for a competitive landscape: an appropriate, flexible, risk-based Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime; conditions for the use of agents as a customer interface; a clear regulatory regime for electronically stored value; and market-based incentives to achieve the long-term goal of broad interoperability and interconnection.

Source: G20(2010)

III. DATA AND METHODOLOGY

The paper has used the secondary data published by Nepal Rastra Bank (NRB), World Bank and IMF. In addition to publication of supply side data by NRB, World Bank's Global Findex database developed by Demirgüç-Kunt,et al. (2018) and IMF Financial Access Survey (2018) have also been used to make comparative analysis. Some data are also drawn from Nepal's Demographic and Health Survey 2016 which covers some information on the use of bank account. Since financial inclusion has both supply and demand side, findings of two demand side surveys conducted so far in Nepal are used here.

On methodological front, this paper follows simple comparative analysis over time and with the situation of South Asian countries based on available secondary data. Simple tables and graphs are constructed to see the changing dimension of financial inclusion using various financial inclusion indicators found in literature in line with World Bank (2014) and Pant (2016). This paper follows the facts finding approach than any empirical estimation.

IV. TREND OF FINANCIAL INCLUSION IN NEPAL

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

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[1]. Informal lenders were the preferred source of working capital for small business. 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 in 2014 by covering a representative sample of 4,014 adults in Nepal, aged 18 years and above across 70 districts. 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

[1] All financial NGOs have been converted into MFIs in 2018/19.

service explicitly. Hence, findings of it are nor 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[2] and 21 percent from other formal[3]), while 21 percent used informal channels[4] 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 groups, however.

As shown in Table 3, two – third of salaried workers had access to bank, this 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 (one-fourth), while the least excluded users are remittance receivers (just 4 percent). Farmers are the second largest users who use informal source of finance, 16 percent of them are excluded, 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).

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2 Includes commercial banks (A Class), development Banks (B class), finance companies (C class) and Micro-finance Institutions (D- Class).

3 Includes non bank formal financial institutions such as cooperatives.

4 Includes money lenders, family and friends, saving groups.

Table 3: Overall Financial Inclusion Scenario (% of adult)

	Bank	Other Formal	Informal	Excluded
Overall	40	21	21	18
Urban	56	15	11	18
Rural	36	22	24	18
Male	45	19	20	16
Female	36	21	23	20
Financial service usage, by target market				
Salaried workers	66	17	8	8
MSMEs	51	21	16	12
Remittance Receivers	52	30	14	4
Farmers	37	24	24	16
Irregular Earners	25	16	33	25
Dependants	29	17	21	33

Source: FinSope Survey 2014 (http://www.finmark.org.za/wp-content/uploads/ 2015/08 /BROCH_FS_Nepal_2014.pdf) 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[5]. 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. Existing policy provisions are presented in section (6).

As shown in Table 4, 27 percent of adults save in banks and another 13 percent save in other formal sector, 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, 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.

[5] 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 (FinScope Survey 2014,, UNCDF, 2016).

Table 4: Product wise Financial Inclusion Scenario (% of adult)

	Bank	Other Formal	Informal	Excluded
Payment	37	11	6#	46
Savings	27	13	16	44*
Credit	10	8	28#	54
Insurance		11	9	80

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

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). In this way, access to credit from formal financial institution is very limited. About 19 percent of salaried workers, get credit from bank, this 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, 84). 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 (FinScope Survey, 2014)[6]. 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 (FinScope Survey 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, these are the top two users of insurance (Table 5).

[6] http://www.finmark.org.za/wp-content/uploads/2015/08/BROCH_FS_Nepal_2014.pdf

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

	Salaried workers	MSMEs	Remittance Receivers	Farmers	Irregular Earners	Dependants
Payment						
Bank	64	49	51	33	21	28
Other Formal	9	8	28	13	6	7
Informal#	1	3	12	4	5	7
Excluded	26	40	9	50	68	58
Savings						
Bank	54	35	25	21	12	16
Other Formal	13	21	12	17	15	14
Informal	8	8	10	17	15	12
Excluded*	26	36	53	45	58	57
Credit						
Bank	19	15	8	10	5	9
Other Formal	12	14	6	9	6	4
Informal#	21	21	30	33	38	19
Excluded	47	50	56	48	51	69
Insurance						
Other Formal	29	23	9	8	5	7
Informal	7	8	7	13	6	8
Excluded	64	69	85	79	88	85

Source: UNCDF (2016)
* included saving at home, # included family and friend

4.2 Barriers on Financial Inclusion from demand side

Regarding the barriers to usage of payments services, FinScope survey in 2014 found that 57 percent of adults consider the requirement of maintaining a minimum balance as a barrier to opening a bank account[7], followed by 47 percent adults - who do not see the need for having a bank account. Further, for about 21 percent adults, the reason for not having bank account is because the bank is far away (UNCDF, 2016, 51).

Proximity is a key access barrier for the usage of saving services of formal financial institutions as depicted by FinScope Survey in 2014. Normally in hill and mountain regions, the time and opportunity cost of travelling to the nearest bank is high. 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.

[7] People can now open zero-balance account.

In regards to the barriers to usage of credit, FinScope survey finds the lack of documentation and collateral as a major barrier for access to credit. About 19 percent of adults who were refused a loan could not provide collateral, while 16 percent could not provide the required down payment. About 44 percent of adult were reported to have not required credit, indicating the low degree of entrepreneurship in Nepal. Another reason for low credit uptake is due to long and costly loan procedure. On average, an individual loan approval process can take up to two weeks (UNCDF, 2016, 88).

Insurance is a very low used product. FinScope Survey finds that affordability is a key barrier, caused by high level of irregular income leading to lack of proof of income which becomes an eligibility barrier for insurance, and the lack of proximity. On usage side, "the relatively low levels of awareness and financial literacy with regards to the insurance products are among the primary reasons for low penetration of the insurance industry in Nepal" (UNCDF, 2016, 101).

4.3 Use of Bank Account: Findings of Demographic and Health Survey 2016

Demographic and Health Survey 2016 also covers some information related to financial inclusion particularly use of bank account from gender and age wise perspective. Some findings are interesting and useful. Some of the findings are highlighted here.

Table 6: Use of Bank Account

Age	**Women**	**Men**		**Women**	**Men**
15-19	11.3	8.3	**Province**		
20-24	32.8	33.5	Province 1	43.0	37.0
25-29	46.7	49.3	Province 2	29.0	35.0
30-34	54.5	50.5	Bagmati	51.0	51.0
35-39	57.0	54.5	Gandaki	53.4	41.0
40-44	52.8	59.7	Province 5	38.7	38.1
45-49	51.0	55.8	Karnali	28.6	26.2
Residence			Sudur Pashchim	33.7	37.1
Urban	45.5	44.4			
Rural	32.0	32.0			
Ecological zone					
Mountain	31.5	36.7	**Wealth Quintile**		
Hill	46.4	42.7			
Terai	36.5	38.2	Lowest	24.3	17.4
			Second	33.9	29.0
Education			Middle	38.6	34.4
No education	37.0	28.3	Fourth	43.8	42.0
Primary	40.1	31.4	Highest	57.4	64.6
Some Secondary	34.6	31.1			
SLC and above	51.7	56.1			

The proportion of men and women who use a bank account is almost similar (40.5 percent and 40.1 percent, respectively). The proportion of women who use a bank account is highest among those age 35-39 (57 percent) and lowest among those age 15-19 (11 percent). Among men, use of a bank account is highest among those age 40-44 (60 percent) and lowest among those age 15-19 (8 percent). The use of bank accounts increase with education (Table 6). About 51.7 percent of women and 56 percent men with education SLC and above use bank account compared to just 37.0 percent of women and 28 percent of men with no education. Similarly, bank account use is highest in the highest wealth quintile (57.4 percent women and 65 percent of men) and lowest among those in the lowest quintile (24.3 percent women and 17 percent men). This shows that education and wealth (or income) matter for use of bank account. In both gender, the use of account is high in urban areas, hills and in Bagmati Province. Surprisingly in many categories, the proportionate use of bank account by women is higher than that of men.

4.4 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)[8]. Further, supply side also includes several indicators for assessing the increase in financial access and inclusion.

As seen in Figure 4, the number of branches of deposit taking bank and financial institutions (A,B and C class), which was increasing at modest rate until 2017, started increasing at a higher rate since then reaching 5533 as of mid-March 2020. With the rapid expansion of bank branches, population per branch declined steeply. This was true especially after 2017, when the ratio lowered to 5289 people per branch on average. However, distribution of branches mainly concentrated in urban and semi-urban areas. Out of 77 districts, 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 (Figure 4). About 22 percent of branches are in Kathmandu Valley (Kathmandu, Lalitpur and Bhaktapur districts).

Other financial inclusion indicators as shown in Figure 5 also exhibit gradual expansion in recent years. 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 2.73 times. The year 2018/19 registered a growth 4.3 million new accounts. However, the number of loan accounts just increased by 1.76 times during the same period. It

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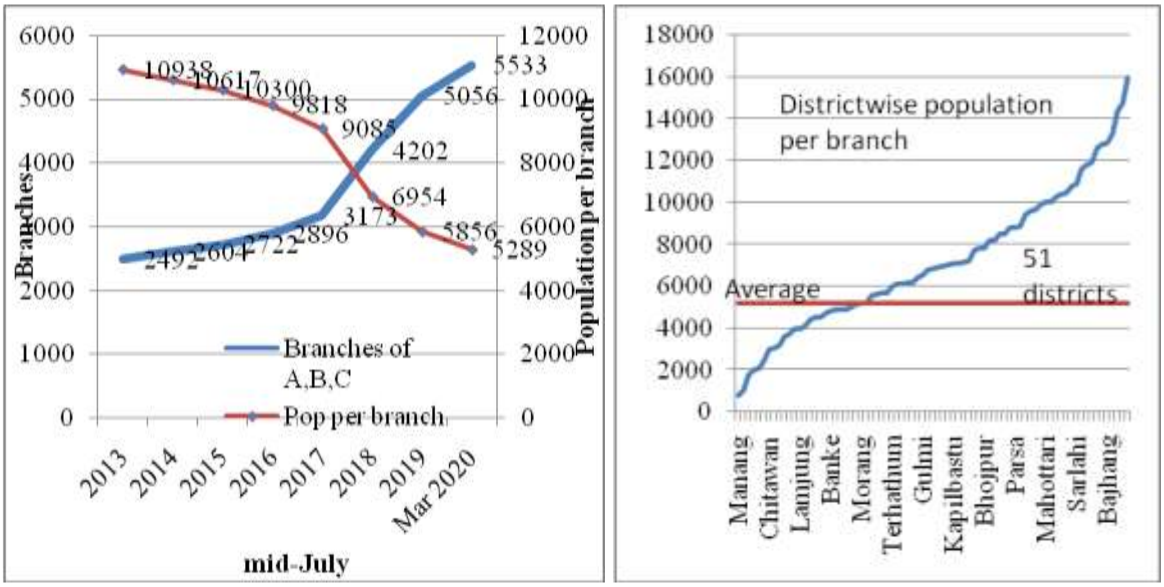
[8] The number of insurance companies has increased from 27 (9 life, 17 non-life and 1 Reinsurance) in 2014 to 40 as of 2020 (19 life, 20 non-life and 1 Reinsurance).

shows the substantial rise in use of banks for saving purpose[9], but a proportional rise in use of credit from banks has remained sluggish[10]. 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 still out of reach of many relatively. This reflects that financial resources are being utilized by limited people who can have access to these financial institutions[11].

Figure 4: Numbers of Branches of Banks and Population per Branch



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, reaching to last mile. 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-January 2020, the number of branches of MFIs increased by about 6 times reaching more than 3800 from just 646 (Figure 6). With the expansion of branches, the number of members increased by 3.6 times and the number of borrowers by 3.1 times during

9 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, 2020). Many deposit accounts are not actively used.

10 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).

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

the same period. As of mid-January 2020, there were 4.6 million members and 2.8 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 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 5: Some Financial Inclusion Indicators

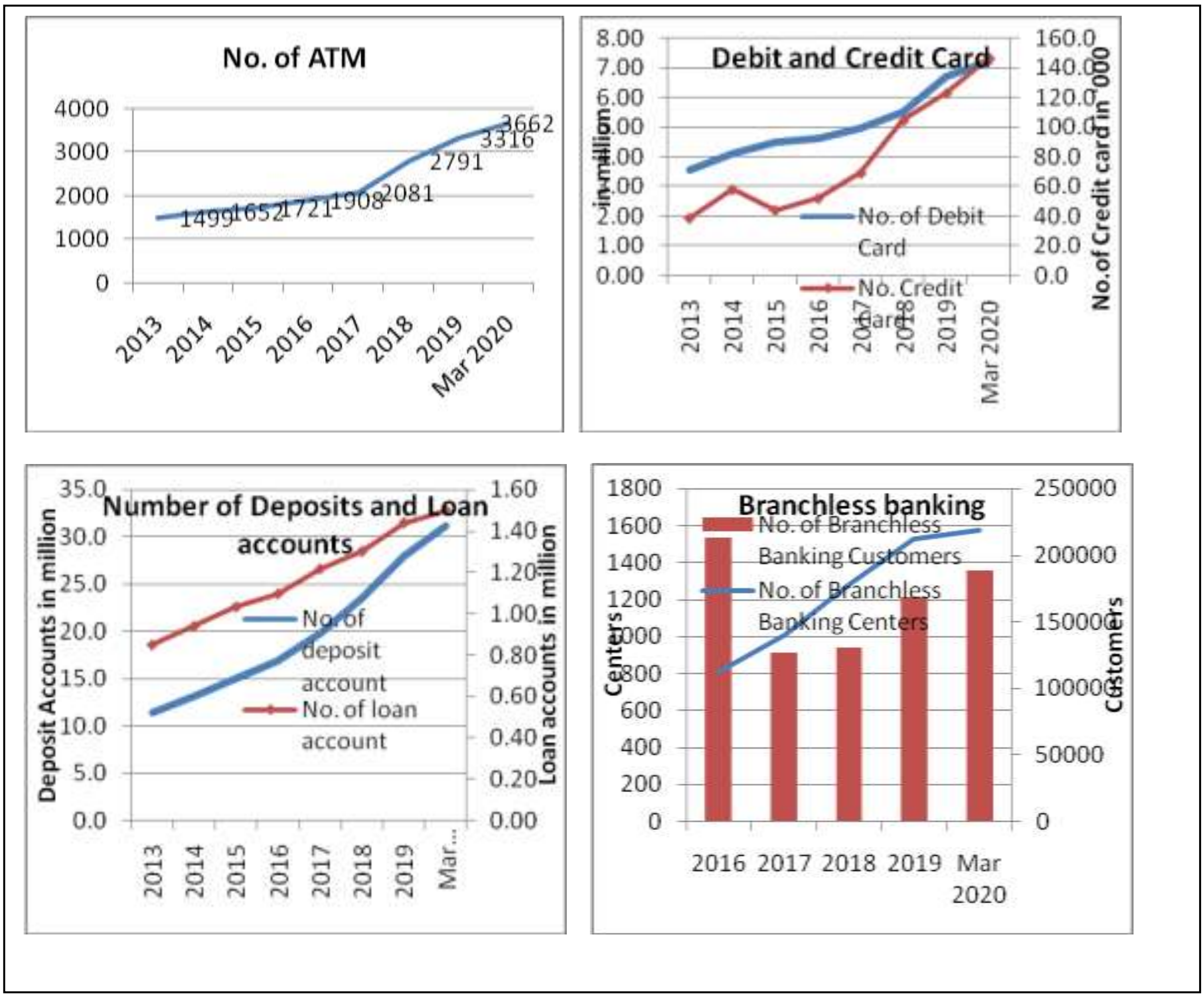
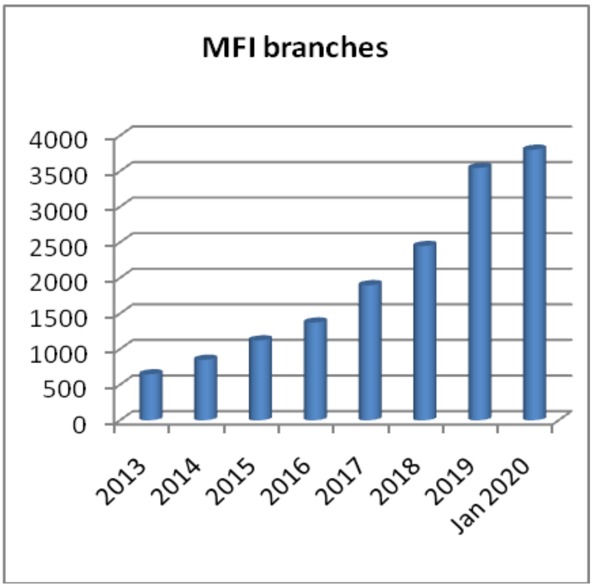
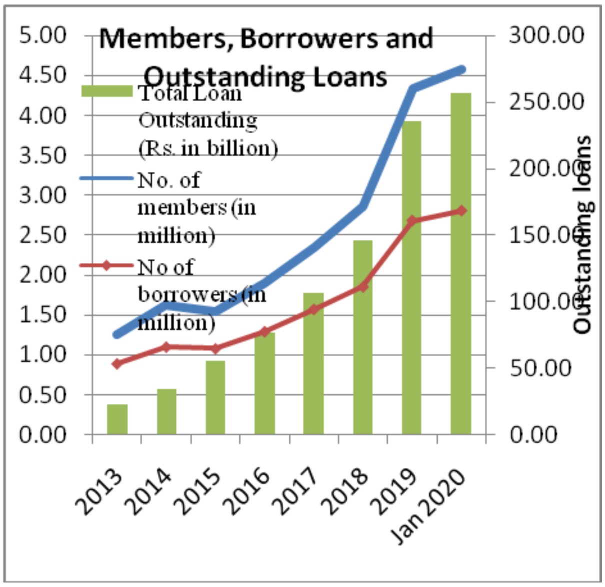


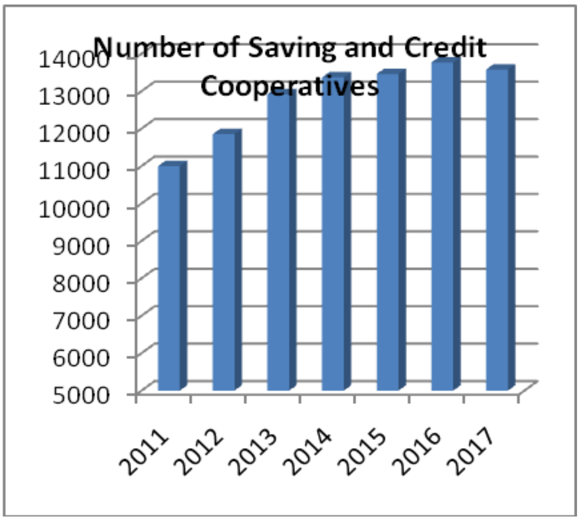
Figure 6: Expansion of MFIs branches and their customers

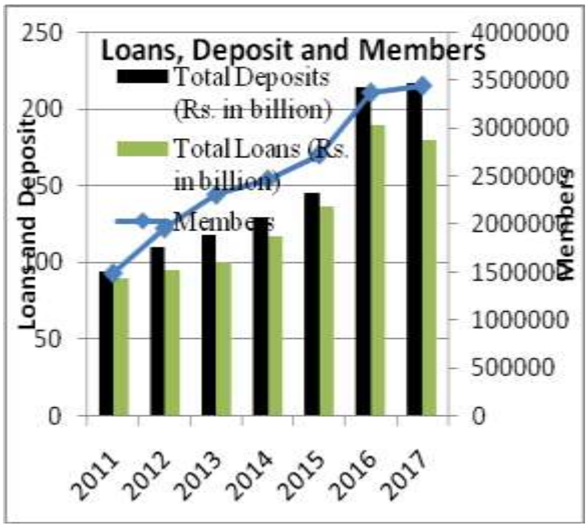




Saving and credit cooperatives, which collect deposits and lend to its members also expanded substantially in the recent decades until 2013 before a slowdown in growth after that. Recent data of saving and credit cooperatives are not available after 2017 because many cooperatives are now under the jurisdiction 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 179.9 billion (Figure 7). In addition to saving and credit cooperatives, there are thousands of multipurpose cooperatives also engaged in some sort of financial intermediation.

Figure 7: Situation of Saving and Credit Cooperatives





V. COMPARISON WITH SOUTH ASIAN COUNTRIES

As section 4 shows that there has been an expansion of access of financial service providers as well as financial services in Nepal. Commercial banks, development banks, finance companies, microfinance institutions and, saving and credit cooperative have been working on providing financial services by expanding their branches. However, it is imperative to also see how the comparative situation of Nepal is with neighbouring South Asian countries[12]. Comparison is done using Global Findex database developed by the World Bank (Demirgüç-Kunt, et. al. 2018).

Percentage of adult having bank account in Nepal has increased from 25 percent in 2011 to 45 percent in 2017 (Table 7). Despite substantial improvement, percentage of adult having bank account in Nepal is far lower than in India and Sri Lanka, and slightly lower than in Bangladesh, but higher than in Pakistan and Afghanistan. Gender disparity in accessing bank account in Nepal is also higher than India and Sri Lanka, but far lower than that in other selected South Asian countries. As of 2017, about 38 percent of adult from bottom 40 percent had bank account, which is lower than that of India, Bangladesh and Sri Lanka, and 12 percentage point lower than that of richest 60 percent. In this way, income inequality is also reflected in inequality on assessing financial services.

Table 7: % of Adult having Bank Account in South Asian Countries

Indicator	Year	Nepal	India	Bangladesh	Pakistan	SriLanka	Afghanistan
Account (% age 15+)	2011	25	35	32	10	69	9
	2014	34	53	31	13	83	10
	2017	45	80	50	21	74	15
Account, male (% age 15+)	2011	30	44	37	17	70	15
	2014	37	63	35	21	82	16
	2017	50	83	65	35	74	23
Account, female (% age 15+)	2011	21	26	26	3	67	3
	2014	31	43	26	5	83	4
	2017	42	77	36	7	73	7
Account, income, poorest 40% (% ages 15+)	2011	14	27	19	5	59	1
	2014	24	44	23	10	79	6
	2017	38	77	40	14	71	14
Account, income, richest 60% (% ages 15+)	2011	33	41	40	14	75	14
	2014	40	59	36	15	85	13
	2017	50	82	57	26	76	16

Source: Global Findex Database

[12] This paper just makes comparison with South Asian countries, not with other advanced countries considering the space limit.

The top most reason for not having bank account in Nepal is insufficient fund (40 percent of adults perceive so), which is also the same in other South Asian Countries (Table 8). Such a situation is due to high degree of poverty and low income. The second main cause is that the financial institutions are too far way - 20 percent of adult in Nepal do not have an account because of this reason. In Afghanistan as well, the second main reason is the same as that in Nepal. Scattered settlement and difficult geographical terrain in hills and mountains are reasons for lacking physical access. About 18 percent of adults do not have account because they share the account of other family members in Nepal. This is one of the main reasons of not having bank account in India.

Table 9a and 9b present the usage of financial services in the selected countries. Though marginally increasing, percentage of adults saving at a financial institution remained just 17 percent as of 2017 in Nepal, which is lower than that of India and Sri Lanka, but the higher than the other remaining countries (Table 9a). Percentage of adults who have borrowed from a financial institution is 4 percentage point lower than that of saving in Nepal. This ratio is the second highest after Sri Lanka. Not only Nepal, but other South Asian countries also have very low access to credit from formal financial institutions.

More than half of adults (e.g. 53 percent) borrowed from family or friend in Nepal in 2017. This is the highest ratio of among South Asian countries. This situation vindicates a weak access to credit for ordinary people in Nepal. In Sri Lanka, just 16 percent of adults borrowed from family or friend - this is the lowest ratio among the compared countries. In India, one - third of adults rely on family or friend for borrowing.

Table 8: Reasons for not having bank account in 2017

	Nepal	India	Bangladesh	Pakistan	Sri Lanka	Afghanistan
Financial institutions are too far away (% age 15+)	20	5	9	16	6	30
Financial services are too expensive (% age 15+)	17	6	10	19	10	21
Lack of necessary documentation (% age 15+)	10	5	9	15	4	21
Lack of trust in financial institutions (% age 15+)	8	4	7	13	5	20
Religious reasons (% age 15+)	3	1	3	12	2	14
Insufficient funds (% age 15+)	40	11	40	44	23	72
Someone in the family has an account (% age 15+)	18	11	12	13	11	14
No need for financial services ONLY (% age 15+)	1	0	3	4	0	2

Source: Global Findex Database

Table 9a: Usage of Financial Services

Indicator	Year	Nepal	India	Bangladesh	Pakistan	Sri Lanka	Afghanistan
Saved at a financial institution (% age 15+)	2011	10	12	17	1	28	3
	2014	16	14	7	3	31	4
	2017	17	20	10	6	29	4
Borrowed from a financial institution (% age 15+)	2011	11	8	23	2	18	7
	2014	12	6	10	2	18	4
	2017	13	7	9	2	15	3
Borrowed from family or friends (% age 15+)	2011	33	20	11	23	13	30
	2014	35	32	25	34	9	22
	2017	53	33	21	29	16	26
Debit card ownership (% age 15+)	2011	4	8	2	3	10	5
	2014	7	22	5	3	25	2
	2017	9	33	6	8	32	3
Debit card ownership, male (% age 15+)	2011	6	12	4	4	12	8
	2014	10	32	8	5	28	3
	2017	12	43	9	14	34	4
Debit card ownership, female (% age 15+)	2011	2	5	1	1	8	1
	2014	4	11	2	0	22	0
	2017	6	22	4	3	31	1

Source: Global Findex Database

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 9a). This might have improved then after as we saw the expansion of number of debit cards issued in the earlier section. In India and Sri Lanka, about one-third of adults have a debit card. That ratio in other South Asian countries is lower than that of Nepal. Widespread gender disparity can be observed in use of a debit card in all selected South Asian countries, fewer female compared to male use debit card.

Table 9b further presents some more uses of financial services. Percentage of remittance senders using a bank account increased from 16 percent in 2014 to 28 percent in 2017 in Nepal. This ratio is slightly higher than that of Pakistan and Afghanistan but lower than that of other countries. Further, just 2 percent of adult used an account in financial institution to pay bill in 2017 in Nepal, which is the second lowest ratio after that of Afghanistan. Only 15 percent of wage recipients receive wages into a financial account in Nepal which is the lowest among South Asian countries (Table 9b). Just 1 percent of adults receive payment of agriculture products in an account in financial institution in Nepal, which is the same as in

Bangladesh, and slightly higher than in other countries. Compared to 22 percent of adults using mobile phone or internet to access account in Bangladesh, that ratio is just 4 percent in Nepal. Other South Asian countries also have this ratio far lower than Bangladesh.

Table 9b: Usage of Financial Services

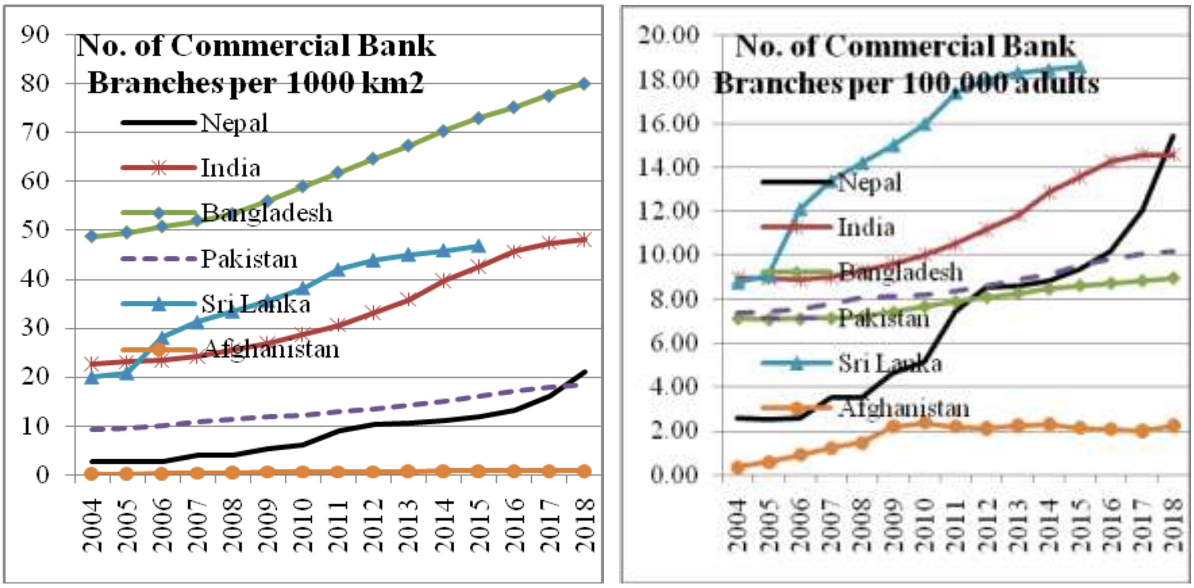
Indicator	Year	Nepal	India	Bangladesh	Pakistan	SriLanka	Afghanistan
Sent or received domestic remittances: using an account (% senders and recipients, age 15+)	2014	16	22	11	6	29	10
	2017	28	38	43	27	34	18
Paid utility bills: using a financial institution account (% age 15+)	2014	0	3	1	0	1	1
	2017	2	6	10	7	21	1
Received wages: into a financial institution account (% wage recipients, age 15+)	2014	12	20	12	7	32	15
	2017	15	31	22	23	44	34
Received payments for agricultural products: into a financial institution account (% age 15+)	2014	0	2	0	0	1	1
	2017	1	3	1	2	3	3
Used a mobile phone or the internet to access an account (% age 15+)	2017	4	5	22	8	8	1

Source: Global Findex Database

Further, based on IMF's Financial Access Survey data, some more indicators of financial inclusion have been drawn such as number of commercial bank branches per 1000 km^2 and per 100,00 adults, as well as number of ATMs per 1000 km^2 and per 100,000 adults. Figure 10 presents the number of commercial bank branches per 1000km^2 and per 100,000 adults. Availability of commercial bank branches per 1000 km2 in Nepal is lower than India, Bangladesh and Sri Lanka, recently overtook Pakistan and far higher than Afghanistan (Figure 10). However, Nepal has observed the impressive improvement in the number of commercial bank branches per 100,000 adults in recent years, even outpacing India in 2018, only lower than that of in Sri Lanka.

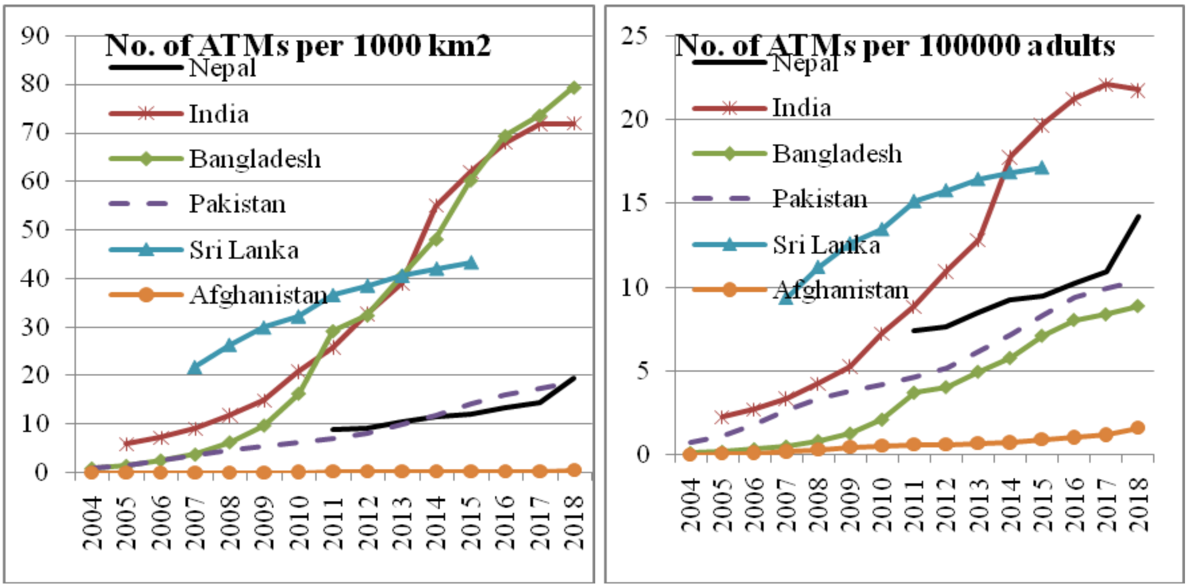
Availability of ATMs per 1000 km^2 is almost same as availability of commercial banks' branches. In this indicator, Nepal is par with Pakistan and higher than in Afghanistan, but lower than other selected South Asian countries (Figure 11). In case of availability of ATMs per 100000 adult, Nepal's position is only lower than India and Sri Lanka, but higher than other three countries as shown in Figure 11.

Figure 10: Number of Commercial Bank Branches per 1000 km² and per 100000 adults



Source: IMF's Financial Access Survey 2018

Figure 11: Number of ATM per 1000 km² and per 100000 adults



Source: IMF's Financial Access Survey 2018

VI. POLICY PROVISIONS FOR FINANCIAL INCLUSION AND RECENT DEVELOPMENT

Since the 1970s, Nepal Rastra Bank and the Government of Nepal have been introducing various policies to increase access to finance by making it more inclusive- these are documented in several publications of NRB. Hence, this paper just highlights the existing policy provisions intended to enhance financial inclusion with a motive of reducing poverty and inequality in the economy in recent years.

Policy Provisions

Major policy provisions currently in operation are listed below.

1. New Branch opening policy has put emphasis by requiring BFIs open branches in unbanked areas. There should at least be one branch of commercial bank in each local body. MFIs do not require permission to open branches in villages and remote areas.
2. Provision of deprived sector lending. This requires that all commercial banks, development banks and finance companies lend 5 percent of their loan portfolio to deprived sector which mainly incorporates the poor and deprived people.
3. Provision of priority sector lending which requires commercial banks, development banks and finance companies to lend 25 percent, 15 percent and 10 percent respectively to the priority sectors which include agriculture, hydropower, tourism, exports, SMEs, pharmaceutical, cement and garment industries.
4. Provision of banning 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 ABBS service up to Rs. 200,000. This provision reduces fees required for using financial services.
5. No advance payment fee can be charged for loans upto Rs. 5.0 million.
6. Provision of establishment of grievance handling desk with designated senior manager. There should be facility of using hotline as well as online services for customers' complaints.
7. Provision of mandatory financial literacy programs to be conducted by all BFIs in their annual programs.
8. Retail Payment Strategy 2019 has been prepared and is in implementation.
9. Any payments of Rs. 1.0 million or more to be made by BFI should be done through account payee cheque or deposit on the account of related person in May 2017. Any cheque issued to firm, company, institution or office should be paid through account. Earlier limit was Rs. 3.0 million from 2016 and Rs. 5.0 million before that.
10. BFIs are required to set up a separate MSME desk to increase the credit flow to this sector.
11. "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 program, 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 provision of opening zero balance account and also announced depositing all government benefit payments in bank account.

12. Labour Bylaw 2018 which was endorsed in May 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 staffers through banking system.
13. The government has been implementing subsidized credit program since 2015 by providing interest subsidy to nine main areas such as commercial agriculture, educated self-employment, migrant returnees, women entrepreneurs, untouchable community, higher and technical as well as vocational education, earthquake victim, technical training and cotton industry[13].
14. NRB has been providing concessional refinance facility to selective productive sectors, exports, sick industry and victim of earthquake of 2015.
15. National Financial Inclusion Roadmap 2017-2030 and Financial Inclusion Action Plan are in implementation phase.
16. Since February 2015, remittance payment beyond Rs. 100000 had to be made through bank account or cheque instead of cash. The limit was revised up to Rs. 200000 in July 2017.
17. Effective in 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.
18. Effective 2014/15, NRB has been conducting "NRB with students" interactions aimed at enhancing financial literacy.
19. Until 2017/18 (starting from 2011/12 for A class and national level B class, and from 2012/13 for MFIs), there was a policy of providing interest free loan by NRB to BFIs (including MFIs) to open branches in unbanked remote areas.
20. The Government of Nepal has recently announced in its Policy Statement for 2020/21 that all government transaction will be cashless by next two years.

Recent Development

In addition to supply side development observed above, because of various policy initiatives, some recent developments are as follow.

1. NRB established Payment System Department in July 2015 in order to develop modern payment system.
2. For the first time, NRB has introduced Licensing Policy for Institution/Mechanism Operating Payment Related Activities 2016 to provide license to payment service providers and payment system operators by using modern financial technology. Accordingly, 13 payment service providers and 9 payment system operators were in operation as of mid-March 2019.

[13] Last two areas have been added recently in 2019.

3. Payment and Settlement Act 2019 has been enacted in 2019 to provide legal framework to make payment system secure, healthy and efficient.
4. Real Time Gross Settlement (RTGS) system has been in operation since September, 2019.
5. Since September 2018, Nepal Financial Inclusion Portal has been in operation, which has been facilitating monitoring of the developments in financial inclusion on a monthly basis.
6. Banks have started opening bank accounts online and several mobile wallets are in operation to facilitate payment process online.
7. Secured transaction registry has been in operation since 2014. Credit Information Bureau operates it.

VII. CONCLUSIONS

Ensuring financial inclusion is essential to make financial system inclusive and to reduce poverty and inequality along with achieving higher economic growth. Enhancing financial inclusion makes availability of financial services to those who are normally deprived from these services at an affordable cost and proximity. Realizing the importance of financial inclusion, it has been given due attention in the world. This is especially true in emerging and developing countries where a large segment of people do not have access to formal financial services.

Financial inclusion is multidimensional 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. However, still 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. As a result, the situation of financial inclusion in Nepal is far lower than in Sri Lanka and India, in many cases on par with Bangladesh, but higher than that in Pakistan and Afghanistan. Nepal can learn from the successes of Sri Lanka and India to enhance financial inclusion.

Scatter settlement with difficult terrain in hilly and mountain region 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.

Several policy provisions are in place in Nepal to enhance financial inclusion. However, these policy provisions need to be implemented effectively. 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.

Availability and usage of financial service should be seen as other essential services like health and education to make financial system more inclusive. 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.

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