CHAPTER – IV

OPERATIONAL AND FINANCIAL PERFORMANCE OF RURAL CREDIT INSTITUTIONS IN NEPAL

CHAPTER - IV

OPERATIONAL AND FINANCIAL PERFORMANCE OF RURAL CREDIT INSTITUTIONS IN NEPAL

4.1 Introduction

Institutional finance is essentially needed for agricultural development. The lack of adequate institutional credit is considered to be the most important factor, which if suitably provided will go a long way to put the economy of the farmers specially the marginal and small farmers on a sound footing. An attempt has been made in this chapter to examine the development of institutional finance in Nepal and to assess the operational and financial performance of the rural credit institutions on the basis of the secondary information available to us. An attempt has also been made to examine the problems encountered by the rural credit institutions in delivering credit to the farmers and also the problems encountered by the farmer borrowers in availing credit from the rural credit institutions.

4.2 The Evolution of Rural Credit Institutions in Nepal

The banking system in Nepal was introduced with the establishment of the Nepal Bank Ltd (NBL) in 1937. However, the activities of the bank were confined to accepting deposits and providing loans only to the commercial sector in Kathmandu and other limited urban areas. The country's central bank of Nepal, namely, Nepal Rastra Bank (NRB) was established in 1956, after nearly two decades. Traditionally, most of the credit needs of the people have been met by private sources such as merchants, moneylenders, relatives and friends. The institutionalisation of rural credit began in 1956 only, when credit cooperatives were established in Chitwan with a view to providing credit support to the farmers.

4.2.1 Cooperative Societies

Initially, cooperatives were introduced in Nepal as credit cooperatives. They worked under the Cooperative Societies Act, 1959. The financial support to the cooperatives came from the Cooperative Development Fund created with a token amount of money provided by the Government. It was only in 1963 that the Cooperative Bank

(which was converted into the Agricultural Development Bank in 1968) was established with a view to providing credit support to the cooperatives. Since then, numerous multipurpose cooperatives have been established to provide credit as well as other services to farmers. However, it had been reported that they had worked in the interest of few rural elites only and the loans provided by the Cooperative Bank and the Cooperative Development Fund had been grossly misused (NRB: 1994). A fact-finding mission was commissioned in 1968 to study the functioning of the cooperatives all over the country. It found that most of the cooperatives were dead and their funds misappropriated by few members. Thus, it recommended for the liquidation of most of the 1,489 cooperatives existing at that time.

The Government, in its effort to strengthen and improve the operations of the cooperatives, launched the 'Cooperative Revitalization Programme' in 1971. The Agricultural Development Bank (ADB/N) was authorized to run 101 cooperatives under its guidance and management. Subsequently, 155 more cooperatives were brought under the control of ADB/N. In terms of loan disbursement, collection, use of funds, number of beneficiaries and other services, the guided cooperatives were found much better than the previous ones.

In 1976, the Government introduced a new programme known as '*Sajha Programme*' in 30 districts of the country. The cooperatives were renamed as '*Sajha Societies*'. There was one Sajha Society for every two to three *panchayats* (now VDCs). The 216 guided cooperatives and 3598 village committees were converted into the Sajha Societies and 487 new Sajha Societies were established. The basic feature of the programme was that the compulsory savings collected under the Land Reform Programme of 1964 were transferred as share capital of the *Sajha Societies* and all the farmers holding compulsory savings were made the members of the *Sajha Societies*. After nearly two years, the Government decided to withdraw the management of cooperatives from ADB/N and handed it over to their respective Management Committees. But the concerned people were not properly informed of the decision. Besides, they were not prepared for the take-over. ADB/N also imposed restrictions in the flow of credit due to poor repayment performance. Most of them started to operate in losses due to rampant increase in manipulations and heavy overhead cost. Then again, a process of merging two to three cooperatives into one had begun. Gradually, they were again returned to the administrative control of the Department of Cooperatives.

There were growing concerns over the ineffectiveness of the lending operations of the cooperatives and their general failure to contribute to rural development. However, at the same time, the need for promoting and strengthening the cooperative sector was also emphasized in subsequent development plans and programmes. A benchmark survey was conducted in 1983/84 by NRB to assess the situation of the cooperatives. It indicated that 94 percent of the cooperatives were in agricultural inputs transaction and 85 percent were in credit operations as well. It was also reported that 75 percent of the outstanding loans of the cooperatives were overdue for more than one year and majority of them were in losses (NRB: 1985).

Various measures have been taken to revitalize the cooperative movement in Nepal. After the political change in 1990, a seven member National Cooperative Consultation Committee (NCCC) was appointed to formulate concrete recommendations for promoting and strengthening the cooperatives. Following the recommendations of the Committee, the Government dissolved the Sajha Central Committee; constituted an 11 member National Cooperative Development Board (NCDB), enacted a new Cooperative Act, and formed a Central Sub-committee to study the problems and potentials of the existing cooperatives. The sub-committee, after the study of 856 primary cooperatives and unions, found a large number of them in non-active stage, only 13.79 percent of them running in profit. It was also found that 83.25 percent of the loan extended to the members was delinquent. However, the Eighth Plan emphasized the role of cooperatives as an important medium for providing credit facilities and other services to the rural people. The Government is working towards improving the operations of the cooperatives through democratisation of their management and creating congenial condition for the promotion of new cooperatives.

4.2.2 Rural Credit Institutions in Nepal

Formal Institutions

In view of existing insecurity situation of the country, more flexible policy is being adopted with a number of commercial bank branches either merged or relocated or closed. As a result, total number of branches declined from 413 in mid-July 2002 to 383 by mid-April 2003. Of the total commercial bank branches, Rastriya Banijya Bank (RBB) has the highest number of branches with 138, and Nepal Bank Limited was second with 15. Altogether there were 18 commercial banks by mid-April 2003. Other

commercial banks have outsourced their rural credit function and have limited rural outreach. The formal credit institutions by mid-April, 2003 were as follows:

- Among 16 development banks, Agricultural Development Bank is the largest with extensive network of more than 650 rural branches in 75 districts.
- 5 Regional Rural Development Banks (RRDB). They focus on women in the farm sector through loans of up to Rs. 5000.
- 34 Cooperative Societies licensed by Nepal Rastra Bank (Central Bank).
- 37 NGOs (Non-Cooperatives) having limited banking functions in micro finance.
- 500 plus cooperative societies registered under Cooperative Department. They are a mix of single purpose and multipurpose.

Informal Institutions

Informal institutions, consisting of individuals and groups, have traditionally played a dominant role in rural credit system. The individuals include moneylenders, landlords, traders, friends and relatives. The groups include informal self-help groups and other local level organizations.

The dependence of smallholders, marginal farmers, poorer households and landless labourers is high on informal sources for credit supply. The demand for credit is largely for consumption and social purposes rather than for productive investments. Moreover, informal credit institutions tend to be exploitative. In 1991/92 more than 80 percent of the borrowing households in the country had borrowed from informal institutions (NSCA: 1991/92). Such institutions fulfilled almost 70 percent of rural credit needs. The National Census of Agriculture, 2001/02 (NCA) found that almost 60 percent households reported as having obtained credit from the informal institutions. This indicates that there is still dominance of moneylenders and landlords in the rural credit system.

4.2.3 Targeted Rural Credit Programmes

The Government has introduced a number of targeted rural credit programmes since 1970s. Their rationale is based on the policy thinking that Government intervention was required to ensure sufficient flow of rural credit. Their objective is to expand access to formal institutional sources of credit for rural poor. Major programmes that are currently being implemented are discussed below.

The Priority Sector Credit Programme (PSCP)

In order to make commercial banks socially responsible, Nepal Rastra Bank since 1975 has given directive to commercial banks to invest in priority sector credit programme. The rates of investment to be made in the priority sector by the commercial banks have been changing from 5 percent of deposits in 1975 to 7 percent of deposit in 1976, to 12 percent of outstanding loans and advances since 1990. This programme covers agriculture, cottage industry and service sectors. It is an umbrella credit programme covering all the targeted rural credit programmes.

Small Farmers' Development Programme (SFDP)

It was launched in 1975 by ADB/N with the assistance of Asian Development Bank. It is targeted to cater to the credit needs of rural poor. Its purpose is to organize small farmers into groups to provide credit on a group- guarantee basis. This programme is viewed as the government's major poverty reduction program. It now covers the entire country.

SFDP, by the end of July 2001, had mobilized group savings of Rs. 78 million and disbursed cumulative loans of Rs.6490 million to 165679 group members. (NRB: 2001)

The total outreach of SFDP has been less than 10 percent of rural population. The concept of group guarantee became " double guarantee" in practice. Borrowers are required to provide physical collateral. Loan recovery performance was also about 40 percent in 2000/2001.The programme has tended to be financially costly and unsustainable (ADB/N: 2003).

Intensive Banking Program (IBP)

Nepal Rastra Bank launched this program in 1981. Its objective is to increase the coverage of poor families to priority sector programme in rural areas. It provides for group-based, collateral-free lending to low-income families. The programme lacks savings component.

The commercial banks regarded IBP as a costly programme imposed upon them. They never practiced collateral-free lending. Most of the loans went to non-agricultural sectors in urban areas. Lending procedures are inefficient and transaction-borrowing costs are high. Loan recovery is poor and loan losses are high.

Monitoring and supervision of loans is weak. Staff incentives for fieldwork are poor (ADB/N: 2003)..

Production Credit for Rural Women (PCRW)

Ministry for Local Development initiated the programme in 1982. It is women focused rural credit programme. It is a socio-economic programme which

- Organizes poor rural women in groups of 4 to 10 members.
- Provides training to the group on feasible income generating activities.
- Provides credit for income generation activities on a group-guarantee basis.
- Engages members in monthly group savings.

The implementing agencies for PCRW are Agricultural Development Bank, Nepal Bank Limited and Rastriya Banijya Bank. By July 1997, PCRW covered 55 districts, disbursed Rs. 360 million to 45,481 members.

The PCRW programme suffers from low recovery rates. Financially, it is not viable and sustainable .The actual coverage of the programme is also low. Viable and profitable investment schemes are also lacking in rural areas (ADB/N: 2001).

Rural Self-Reliable Fund (RSRF)

The Government initiated this fund in 1991. Its executing agency is Nepal Rastra Bank. It works through NGOs and cooperatives to raise economic and social status of rural poor and marginal farmers by financing their employment activities.

However, its outreach is limited due to small size of core capital. It also suffers from procedural delays in loan approval and disbursement (NRB: 1999).

Micro Credit for Women Project (MCWPP)

The Ministry of Local Development (MLD) initiated this project in 1994 with loan assistance from Asian Development Bank and Grant assistance from Japan and Norway. It involves NGOs as conduits for service delivery to poor women. The target clients are poor women in rural and urban areas. Agricultural and non- agricultural activities are financed.

By July 2001, in 67 districts 25,023 women groups were formed and Rs. 663 million were disbursed to 127,390 women borrowers. The loan recovery rate was 58 percent. However, its impact has been limited because of reluctance of bank

branches to supply credit without physical collateral. Moreover, NGOs lack institutional capacity and experience of saving and credit management. The interest margins are not enough to sustain their costs of operations (Upadhya: 1997).

Grameen Bikas Banks

The five Grameen Bikas (Rural Development) Banks represent an innovative outreach model for assisting the poorest among women living in remote areas. They open up the only source of institutional credit to the poor women to take up locally worthwhile economic activities. While the focus is on the low income group households, the distinctive features of the bank's operations are the group approach to providing credit, and imparting knowledge of credit disciplines to group members as a pre-condition for providing credit. While loans are made without collateral and on group guarantee basis, group mechanism is used to an extent to bring about mutual supervision for proper use of credit and its repayment as well as for group savings. The concept of market/service center is proposed to be followed in order to ensure that raw materials are available for the production activities of beneficiaries and markets for their products.

4.3 Need for Expansion of Rural Credit Institutions in Nepal

Basic concern of any developing country is 'Rural Development'. The term 'Rural' essentially means an area, which is characterized by non-urban style of life, occupational structure, social organization, and settlement pattern. When we talk about the rural system, we can immediately summarize the rural scenario as un-developed or under-developed having inadequate infrastructures (i.e. roads, electricity, irrigation, communication, hospitals, schools, drinking water etc.) non-monetised and agro-dominating economy, illiteracy, traditional culture, superstition etc. These features of rural economy, to some extent, are common in undeveloped or developing countries all over the world. So basic thrusts of the rural credit institutions is to eradicate and reform this type of traditional, rigid and backward condition of the rural economy and achieve modernized and dynamic stage.

Nepalese farmers generally suffer from acute poverty. Nearly 38 percent of the people are below the poverty line (Tenth Plan). Because of poverty of the farmers, they could not use the better seeds, manures, modern implements and other basic requirements to increase the agricultural productivity. As there is acute shortage of credit institutions in the country, they are not able to avail the required credit in time.

The process of lending credit is also very tiresome and big time consuming so most of the farmers are deprived of loan by such institutions. Basically the farmers are illiterate and so they find it easy to take loan from the village moneylenders who charge exorbitant rate of interest. The terms and conditions of the credit are such that the farmers have to sell their produce at a very cheap rate soon after the harvest is over to repay the loan to the moneylenders. Hence they do not get the right price for their produce. As a result the farmers are to be the debtor for whole of their life. In order to free them from the clutches of local traders and village moneylenders, the government has to make provision for credit facilities by establishing rural credit institutions in the rural areas. These rural credit institutions may provide credit to the needy farmers at the time of their need with low rate of interest.

Credit is the lifeblood of all economic activities. In the production of commodities, the requirement for capital credit arises for the purchase of land, the construction of buildings, the purchase of raw materials, machinery and other inputs, and for the hiring labour. However in the case of agriculture credit refers to the amount of money that the farmers borrow to meet their production requirements as well as their current consumption needs. Farmers may borrow to purchase new agricultural land or to release mortgaged lands, to make permanent improvement of lands and to purchase various inputs of production. The money that is borrowed by farmers to meet all such requirements is termed as 'agricultural credit'.

It is clear therefore that credit plays a vital role in accelerating agricultural productions. Provision of technical services alone is not enough to attract farmers to modern agricultural technology. They also need financial support for the shift from the low-yielding traditional agriculture to more costly but highly productive modern agriculture. Modern agriculture comprises the use of improved inputs like high yielding varieties (HYV) of seeds, chemical fertilizers and pesticides, irrigation and so on, all of which require capital investment. Even after new production techniques have been adopted, agricultural credit also has the potential to remove many of the economic constraints that continue to be faced by the rural population, including small and marginal farmers. This is true for both farm and non-farm activities.

In Nepal like in many other developing countries, the majority of the poor farmers cannot afford to undertake these investments. The only solution that can benefit them is the smooth flow of agricultural credit in adequate amounts.

Agricultural production can be raised in two possible ways: Firstly, through extensive agriculture that brings more land under cultivation, and secondly, through intensive agriculture involving the introduction of improved technologies in agriculture. In Nepal, the area of agricultural lands is limited since almost all-cultivable land has already been brought under cultivation. Thus, the use of modern scientific methods of agriculture on wide scale is the only way for increasing production. Adoption of modern agricultural methods including crop rotation and multiple cropping involves huge capital investment. Since a vast majority of the farmers in Nepal are extremely poor, and cannot undertake the required capital investment from their personal savings, adequate credit has to be provided to them.

But still today the overall performance of the rural credit institutions in Nepal is not that extensive and satisfactory. Since 1992, due to insecurity situation in the rural areas of Nepal, the situation has even more deteriorated. The outreach of formal sector in the rural areas has been very poor. Also it is seen that the formal sector banks generally cater only to the needs of rich and bankable borrowers who have collateral and other tangible assets to offer as security.

On the other hand the semi-formal sector, namely, non-governmental organizations (NGOs) and community-based organizations (CBOs) have been successful in reaching the poor people. But these organizations offer a very limited coverage of credit services. It is because most of the NGOs are wholly dependent on the grants and subsidies provided by international donors. Other than these, the NGOs target one section of the rural poor and disburse loan to them for common traditional activities. They do not in general address the problems of finance in agriculture which in fact is the principal problem in the agricultural sector of Nepal. Their investment pattern is not directed towards individual needs of the farmers. Many NGOs charge high interest rates at least to cover the cost of their services. In many cases it happens to be more than 30 percent.

The informal source of credit still plays a very significant role in rural Nepal. The successful existence of informal sector is due to the fact that formal credit sector is not easily accessible to the rural poor. The informal sector is popular among the rural poor not because it is to their advantage from the point of view of cost of borrowing but because it is in the same locality where they live and free of any formalities. But this sector is also has critical problems. It is widely known that the moneylenders and landlords charge high interest rate; sometimes 100 percent or more. So taking credit

from this sector is not at all cost-effective for the rural people, specially for the marginal and small farmers.

Considering the nature of purpose of credit and categories of beneficiaries, rural finance programmes should cover two groups, namely, the agricultural group and the non-agricultural group. Agricultural credit is needed for the farmers for increasing agricultural production, which is the prime concern of Nepal to develop the agricultural sector. Non-agricultural credit is needed for the rural poor for increasing income, savings and self-employment opportunities to alleviate poverty from the rural areas. The above analysis shows that the purpose of non-agricultural group is served by the semi-formal and informal sectors successfully. It is also true that semi-formal sector provides some real services to the rural poor who are deemed to be credit-unworthy by the formal sector banks. The informal sector satisfies the immediate consumption demands of the large section of the rural people. But the formal one, i.e., agricultural finance has not been appropriately taken care of by semi-formal sector. And this is also not possible for this sector because of its fund constraint. Informal sector on the other hand, is a necessary evil in the sphere of agricultural finance. So it is important to expand the formal sector for agricultural finance in the rural areas.

The following points highlight why there is an urgent need of expanding rural credit institutions in Nepal.

- To mobilize the uncaptured micro saving.
- To develop the agricultural sector.
- To supply the required amount of credit to needy people on project viability basis.
- To augment the production, productivity, and income and generate employment by which economic condition of the poor could be boosted up.
- To put into best use the relevant rural technology in the appropriate production process.
- To develop the small markets from pocket to pocket for mutual exchange of their goods and services by rural people.
- To provide support for the development of rural economic and social infrastructure.

- To transform the rural economic system into semi-urban economic system gradually.
- To link the rural economy with urban economy thereby to help in the economic integration and ultimately make a single featured economy i.e. developed and dynamic economy.
- To reduce the regional and sectoral imbalances by providing more financial opportunities to low developed areas.

4.4 Operational Performance of ADB/N

Agricultural Development Bank of Nepal has been occupying a premier position in the institutional rural credit system in Nepal. Started initially with 14 branches and about 125 staff members, handed over as the legacy of the then Cooperative Bank, ADB/N presently operates through seven Supervision and Control Offices at regional level and the 556 delivery networks consisting of main branches, branches, sub-branches, Small Farmers Development Project (SFDP) offices at field level with total of 4,135 officials and staff. It stands to be the single largest organization supplying credit to the agricultural and rural sectors. It shared 93.5 percent of total institutional rural credit supply in the Sixth Plan period (1980/81-1984/85) and 80.9 percent in the Seventh Plan period (1985/86-1989/90). Its share in the institutional lending in the years 1999/00 and 2000/01 remained 77.7 percent and 84.6 percent respectively (ADB/N: 2002).

4.4.1 Loan Policies

ADB/N has laid down comprehensive policies and procedures for conducting its lending operations. The main policy mandate of the bank is to provide loans for agricultural production activities, agro-based business and enterprises and rural industries that promote employment opportunities for rural people. It has classified its loan operations into various purposes, like cereal and cash crops, farm mechanization, irrigation, biogas, land development, agro-inputs marketing, agro and cottage industries, godowns and cold stores, agro- business, tea and coffee, rural housing and in terms of loans, like short-term, medium-term and long term. The clientele is classified as individual cooperatives, corporate bodies and small farmers. The bank generally makes loans against collateral security and up to the limit of 60 to 80 percent of the value of the collateral.

4.4.2 Loan Disbursement

ADB/N has a system of setting target for loan disbursement and recovery in aggregate level and also at branch level for each fiscal year taking into account the previous years' achievements, new opportunities and potentials, and resources to be available for lending. Its lending performance during the years 1997/98 -2001/02 was about 96 percent of the target on an average. The highest growth rate 34.1 percent was recorded in 2001/2002 and the growth rate in 2000/2001 was negative (MOF: 2002/03).

Purpose-wise, agri-business accounted for 20 percent, cereal crops 17 percent, agro and cottage industries 16 percent, cash crops 12 percent, irrigation 10 percent and each of farm equipments and agri-inputs eight percent of the total loan disbursed in 2001/2002. From 1997/98 to 2001/2002, the volume of credit to cereals and cash crops increased by 54 percent and 67 percent, respectively; but the prices of fertilizer and other inputs also increased by over 50 percent. The livestock loans also could not expand to the desired extent due to the lack of better prices for products and the absence of proper marketing facility (MOF: 2002/03).

4.4.3 Loan Recovery and Overdue Situation of ADB/N

The recovery performance against the set target remained between 75 percent and 105 percent with average of 90 percent achievement during 1997/98 to 2001/2002 (NRB: 2002/03). The recovery in 2001/2002 was recorded to be the highest in amount with an increment of Rs. 391 million over the previous year and the growth rate of 52 percent. In relation to the increasing loan overdue, however, the recovery rates are yet low and need attention of the bank.

In 2001/2002 the average growth rate of overdue was 15.5 percent during the period 1997/98-2001/02. The share of overdue in the outstanding (principal only) was over 40 percent during the years 1999-2001 (NRB: 2002). The mounting overdues can be attributed to both internal factors, such as improper selecting of borrower or project, defective repayment schedule, lack of adequate follow-up and supervision, inadequate collection efforts and delayed actions against wilful defaulters, and external factors that are beyond the control of ADB/N, such as crop failure, natural calamities, lack of market support for produces, lack of technical support from line agencies, poor management of enterprises, non-viability of raw materials and inconsistency in Government policies.

4.4.4 Network Expansion of ADB/N

The expansion of ADB/N network mainly took place in 1975/76, when 64 new depot offices and 11 SFDP offices were established, increasing the total network strength to 131 from 54. The continued expansion reached its peak in 1990/1991, when the number of offices reached 690 consisting of 14 zone offices, 59 branches, 101 sub-branches, 56 depots, 18 banking branches, 435 SFDP offices, 5 Regional Training Centres and 4 Appropriate Technology Units. At present it has 650 rural branches in 75 districts of the country. (ADB/N:2003)

4.4.5 Supervision and Follow-Up

ADB/N loan recovery procedure has specified that all borrowers should be supervised and followed-up by the concerned field office at least once in a year. The bank staff should make personal contact with the borrower one month before a loan is due for repayment. However, supervision and follow-up is generally weak and inadequate. A tendency is noticed among the staff to reach borrowers only after a loan is found to be overdue (NRB: 2003)

4.5 Commercial Banks in Nepal

4.5.1 Organizational Structure

The Nepal Bank Ltd. and the *Rastriya Banijya* Banks are the two major commercial banks in Nepal. The former is fully owned by the Government whereas the Government holds over 50 percent of the shares of the latter. Both the banks are based on a three - tier organizational structure, consisting of head office, regional offices and branches.

4.5.2 Operational performance of Commercial Banks

4.5.2.1 Loan Policies and Procedure

The priority sector loans are broadly categorized into three sub-sectors, namely, agriculture, cottage industry and services. The target groups are classified as low income and high-income families. The borrowers, in general, are required to make 20 percent contribution to total project cost, but it is relaxed for the low-income borrowers and up top the loan size of Rs. 15000. The banks generally make loans with a collateral security (NRB: 2002).

As a process, the banks have to conduct household surveys to identify the target group and potential activities for financing under PSLP. But it is not followed and household information is collected only from the farmers who come for loan. During the survey conducted by the researcher most of the marginal and small farmer borrowers reported that they were also unaware of the terms and conditions of loans, such as rate of interest, penal interest, and repayment date. The efforts for collection of loans are also inadequate. The reminders for loan repayment to borrowers are not sent on time and personal contact for loan collection is late. The borrowers complained that loan instalments are not provided as per the need of the project. This had forced them to borrow from local moneylenders at higher interest rates.

4.5.2.2 Loan Disbursement

The disbursement of loan, which increased till 1990/91, decreased from 1991/92, mainly due to decrease in the disbursement by NBL The share of NBL in the total disbursement was 77.5 percent in 1987/88, which decreased to 36 percent in 2001/02, whereas RBB's share improved from 22.5 percent in 1987/88 to 60.7 percent in 2001/02(NRB: 2002). Recently, a passive tendency has been noticed among the commercial bank officials towards the priority sector lending. There is a lack of adequate efforts and initiatives among the branches for the exploration of new lending opportunities and identification of potential clients (Ibid).

4.5.2.3 Loan Recovery

The loan recovery performance deteriorated especially after 1990/'91. The recovery rate, which was recorded at 56.5 percent in 1987/88, declined to 45.9 percent in 2001/02. The declining recovery performance was due, among others, to reasons such as the trade impasse with India, political situation, and, above all, inadequate efforts for collection made by branches (Ibid).

4.5.2.4 Overdue Situation

The growth rate of outstanding loan, which was 34.5 percent in 1997, went down to 7.1 percent in 2001/2002. The growth rate of overdue was recorded at 89.7 percent in 1998/99 and 46.7 percent in 2000/01(NRB: 2002). The ratio of overdue to outstanding loan increased from 14.3 percent in 1997/98 to 28.8 percent in 2001/02, and that of overdue to total principal due also increased from 43.5 percent in 1997/98 to 54 percent in 2001/02. Cottage industry loans showed the highest overdue rate of

59.7 percent followed by agriculture (53 percent) and services sector (44.6 percent) in 2001/02 (ADBN: 2002). The main reasons for large overdues are lack of timely follow-up visits, delayed sending of reminders, poor appraisal of loan, defective repayment plan and delayed actions against wilful defaulter.

4.5.2.5 Staffing and Productivity

As of 2001/02, NBL had 7,567 staff consisting of 30 percent support staff and RBB with 6,365 staff consisting of 35 percent support staff, mainly guards and peons. The staff productivity in terms of disbursement, recovery and outstanding loans and deposits had increased substantially over the years between 1997/98 and 2001/02. However, due to continuous increase in staff, the total income of the banks could not increase commensurate with the expenses. At the field level, most of the rural branches of the banks were found to be in losses, mainly due to high personnel cost and inadequate volume of loan operations. However, staff provision for priority sector operation was very inadequate. The level of staff motivation in both the banks was very low. The priority sector branches seemed to have made negligible efforts for exploring new business opportunities at the local level. Besides, provision of training for field managers and staff had been found to be grossly inadequate (NRB: 2002).

4.6 Financial Performance of Rural Credit Institutions in Nepal

Financial performance of three major credit institutions viz., NBL, RBB, and ADB/N has been examined through analysis of various financial indicators. The sources of information are the published annual reports as well as provisional financial statements of those institutions and information obtained through various sources.

4.6.1 Credit-Deposit Ratio of Banks

Credit-deposit ratios are calculated considering separately the outstanding advances against the total deposit liabilities and total fund deployed (i.e. advance plus investments in Government securities against the total deposits). The table 4.1 shows that NBL had very much maintained a consistent ratio of over 60 percent over the years but for 2000 when the ratio declined to 54.7 percent. Conversely, RBB's position was deteriorating. However, since NBL's advances figures are also inclusive of interest receivable amounts and as such the ratio is window-dressed. Though NBL's financial statements did not disclose the extent of interest receivable clubbed into the 'advances' information available from NRB for the last three years disclosed

that the amount of outstanding interest receivable in the case of NBL amounted to Rs.1505.9 million, Rs.1195.1 million and Rs.1327.5 million respectively. Excluding these amounts from advances, the credit/deposit ratio for NBL would come to only 48.3 percent, 44.9 percent and 51.4 percent, which was far more less than that of RBB. Therefore, compared to the credit/deposit ratios maintained by the other banks, the performance of NBL was not satisfactory.

Table 4.1: Credit/Deposit Ratio of Banks

(FY 199798 -2001/02)

(In Percent)

Banks	July1997/98	1998/99	1999/00	2000/01	200102'
NBL	61.6	61.0	62.4	54.7	51.3
RBB	64.6	60.9	54.7	51.2	50.2
ADBN	102.3	88.5	82.0	73.3	68.2

Source: Balance sheets of respective banks.

Note: The Fiscal Year (FY) in Nepal commences from 15th July and ends on 14th July; FY 1997-1998 for instance, covers the period between 15th July 1997 to 14th July 1998.

ADB/N's credit/deposit ratio is calculated including loans and refinance it had received. The impressive ratio of 102.3 percent since 1997/98 consecutively went down to 68.2 percent in July 2001 implying the slowing down in its lending activities.

4.6.2 Credit Disbursement

Attempt has been made to analyse the credit disbursement by commercial banks against the total disbursable fund. The disbursable fund has been defined as the aggregate of recoveries made during the year and net increase in loanable deposits (i.e. net increase in deposits minus minimum amount required to be set aside liquid funds in the form of Cash Reserve and Statutory Liquidity Ratios). The resultant ratios of disbursed amount to total disbursable fund are given in the table 4.2 below.

Table 4.2: Ratio of Disbursed Amount to Total Disbursable Fund

(In percent)

Banks	July1999/2000	2000/01	2001/02
NBL	91.6	97.2	93.9
RBB	94.7	93.9	91.5
ADB/N	65.5	72.0	70.7

Source: ibid

Though a uniform credit extension in the last years is visible from the table 4.2, both NBL and RBB could achieve better result in 2001/2002 in that they were able to extend credits more than they accumulated. In other words, part of previously unutilised funds had also been used. However, one particular point to be reckoned here with has been the imposition of additional statutory liquidity ratio (SLR) of 24 percent by NRB in that year restricting severely the lending capacity of the banks. Therefore, on account of deduction of deposits by additional 24 percent in that year with relation to earlier years, the total disbursable fund had come down which resulted in the exhibition of higher ratio for that year.

In order to examine the actual improvement in credit extension, attempt has also been made to analyse the total disbursement vis-à-vis recoveries only, which is shown in table 4.3. The table has indicated that the net additional credit disbursement over and above the recoveries made during the year was very much nominal in the case of both NBL and RBB though there were improvements in 2001/2002. This implies that the banks were not successful in deploying adequately the new resources generated through deposit collections. In other words, the liquidity in the banking sector was increasing. The result is that of lower credit/deposit ratio and ultimately low returns. In the case of ADB/N, the proportion is much higher which implies its continuous credit expansion.

Table 4.3: Percentage of Amount Disbursed Against Total Recoveries

Banks	July1999	2000	2001	2002
NBL	107.1	104.4	103.0	110.7
RBB	106.1	100.3	106.4	110.2
ADBN	143. 7	144.6	155.0	145.8

Source: Ibid

4.6.3 Credit Recovery and Overdue

The volume of credit outstanding with the banks was on the rise though not in proportion to the growth in deposits. Increased volume of credit is absolutely necessary for ensuring profitability. However, the increase in the volume of credit is one aspect; the quality of the same is another. Credit recovery is related to the credit, which becomes due. Therefore, for the analysis of recovery ratio, precise information as to the recoveries made against loans which have become due will be required and it can not be related fruitfully to the outstanding credits at the year-end or for that matter a particular period. Such information was not available. In the

absence of such information, therefore, no attempt was made to analyse the adequacy of loan recoveries.

According to table 4.4 the overdue portion is increasing. As for NBL and RBB, the reduction in the proportion in 2001/2002 was largely due to the release of payment (in the form of bonds) by Government against non-performing credits to public enterprises, which resulted in reduction of the outstanding credit as well as the overdue amount. The increasing amount of overdue is very much indicative of the deteriorating state of financial health of the banks. The increment in overdue loans despite clearance of overdue credits to public enterprises is the indication that the quality of private sector credits was also worsening.

Table 4.4: Ratio of Overdue to Total Credit

(In Percentage)

Banks	1997/98	1998/99	1999/00	2000/01	2001/02
RBB	20.1	23.0	30.5	25.6	21.9
NBL	23.0	22.4	34.8	29.9	14.2
ADB/N	38.7	34.3	40.8	44.9	41.5

Source: Ibid

4.6.4 Overdue and Non-Performing Loans

The analysis of the sector-wise overdue is produced in table 4.5. NBL was successful to contain the overdue loans particularly in commercial and consumption sector whereas the ratio increased in the case of industrial loans. So far as the agricultural sector is concerned the ratio increased drastically in 2001. One particular noteworthy point here is that, while the annual disbursement in this sector had fallen significantly, the overdue amount was increasing. The ratio is alarmingly high in the case of commercial loan and this contributed to increase the proportion of overdue loans in aggregate.

Table 4.5: Sectoral Overdue Loans

(Percentage of Outstanding Loan)

	1997	1998	1999	2000	2001
Agricultural Sector					
NBL	50.5	37.4	10.8	17.5	28.1
RBB	24.7	25.3	17.7	19.2	21.8
Industrial Sector					
NBL	16.4	22.7	26.9	20.9	23.4
RBB	15.6	13.9	29.4	23.5	19.6
Commercial + services					
NBL	32.4	24.9	21.7	11.3	11.0
RBB	31.6	39.4	47.5	35.5	30.1
Consumption+ Social					
NBL	15.6	16.9	22.3	14.1	11.1
RBB	11.1	12.4	13.9	16.0	10.8

Source: Economic Report, NRB, 2002

The sector-wise overdue loans of ADB/N are presented in the table 4.6 below.

Table 4.6: Sector-Wise Overdue Loans of ADB/N

(In percent)

Particulars	1997	1998	1999	2000	2001
Cereal and Cash Crop	59.7	59.2	64.6	69.3	71.3
Farm Mechanization/irrigation	34.5	35.2	35.9	37.5	28.4
Agro-Business	31.2	31.7	32.5	34.3	36.2
Agro-Industries	36.3	37.1	41.3	41.6	43.1
Horticulture, Tea/coffee	11.9	11.1	8.6	8.7	9.5
Housing	-	-	1.5	12.5	21.2

Source: Ibid

The highest amount ADB/N lends is in the cereal and cash crop sector and this sector also had got the highest overdue loans, which reached 71.3 percent as of July 2001(Table 4.6). Similarly overdue portions is found to be increasing in other sectors also.

4.6.5 Profitability Ratios

The main findings on different aspects of operational and financial activities of the three institutions do not produce a satisfactory result. It is, therefore, inevitable that the profitability of these institutions would suffer, as is the situation. The profitability of these institutions has been examined through the use of various ratios.

4.6.5.1 Deposit Interest Payout vs. Interest Income on Advances

As a matter of fact, commercial banks have been maintaining a good spread (exceeding six percent) in interest rates. The maximum aggregate rate of interest on deposits comes to less than ten percent while the lending rates varied from 14 percent to 16 percent. Therefore, simply calculated on the basis of six percent spread, the interest they pay in deposits could easily be realized with deployment of 55 percent of the deposits in advances. But despite attaining this level of credit/deposit ratio they have not been able to break even the interest expenses, as indicated in table 4.7.

Table 4.7: Ratio of Interest Paid on Deposits to interest Income from Advances

(In Percent)

	1997/98	1998/99	1999/00	2000/01	2001/02
RBB	78.0	92.8	102.1	116.3	124.0
NBL	111.5	115.7	107.8	100.0	170.1
ADB/N	58.1	56.0	58.3	64.5	58.3

Source: Obtained from Nepal Rastra Bank, Kathmandu, Nepal

The ratio of more than 100 percent indicates the excess of interest payout in deposits than the interest receipt in advances. Therefore, as a matter of fact, the higher ratio indicates the use of income received by way of other sources (e.g. interest received on investment) towards interest payment to deposit holders. Therefore, the lesser is the ratio, the more comfortable position for the banks. However, as the table has indicated, the situation of both NBL and RBB is deteriorating on this count. While there was a continuous increase in the ratio for RBB, the position for NBL became more alarming in 2001/02. In the case of ADB/N, the interest paid amount is calculated inclusive of interest on borrowings since borrowings consist of a sizeable amount of available fund for that bank. The position of the bank is seen comfortable so far as this ratio is concerned.

On the basis of the above analysis we find that the payback situation and the volume of overdue of the credit supplied by the rural credit institutions in rural sector

present disappointing trend. It is a difficult situation where neither the credit supply can be stopped, which will affect economic development of the country, nor can the supply of loan be continued without the recovery of past loans.

4.7 Problems Encountered by Farmer Borrowers and Rural Credit Institutions in the Sampled Area

In this section we have made an attempt to discuss the problems faced by farmer borrowers and rural credit institutions on the basis of our field investigation. For this purpose personal interview method was adopted by us with the bank officials and personal interview method was adopted to elicit views from the farmer borrowers through questionnaires prepared for the survey. The results of the survey obtained from each of the respondents are mentioned below.

4.7.1 Farmer Borrowers

Timely and Adequately Supply of Inputs

Supply of farm inputs in adequate quantities and in time is an essential requirement of the farmer borrowers. It is seen that the majority of the farmers had not received the farm inputs timely and in adequate quantities. This is seen from the table 4.8

Table 4.8: Supply of Farm Inputs to Farmer Borrowers on the Basis of Timeliness and Adequacy

Area	Received timely and adequately	Not received timely and adequately	Neutral	Total
LDA	22 (29.33)	45 (60)	8(10.67)	75 (100)
MDA	31(41.33)	39(52)	5(6.67)	75 (100)
DA	46(61.33)	22(29.33)	7(8)	75 (100)
All	99 (44)	106 (47.11)	20 (8.89)	225(100)

Source: Field survey 2001

Note:- *Figures in brackets indicate percentage to the total*

LDA = Low developed area; MDA = Moderately developed area ; DA = Developed area

The table 4.8 indicates that only 44 percent of the total farmer borrowers agreed that they had received farm inputs timely and adequately to undertake agricultural operations. On the other hand about 47 percent of the farmer borrowers confirmed that they had not received farm inputs in time and in adequate quantities. The remaining farmer borrowers constituting about 8,89 percent of the total borrowers, however, maintained a neutral stand. If we compare area wise we see that the proportion of farmers who did not receive farm inputs timely and adequately is

decreasing from low developed area (LDA) to developed area (DA). It indicates that there is less concentration of the input supplying agencies in the low developed area of Morang district.

Supply of Loan in Time and in Adequate Quantity

Farmer borrowers require credit before the beginning of agricultural season. This would help them to complete the cycle of production. The response on this issue by farmer borrowers was mixed one. This is seen from table 4.9

Table 4.9: Supply of Loans to Farmer Borrowers by Formal Credit Institutions on the Basis of Timeliness and Adequacy

Area	Received timely and adequately	Not received timely and adequately	Neutral	Total
LDA	17 (22.67)	47(62.67)	11(14.67)	75 (100)
MDA	24(32.0)	43(57.33)	8(10.67)	75 (100)
DA	31(41.33)	36(48.0)	8(10.67)	75 (100)
All	72 (32.0)	126(56.0)	27(12.0)	225(100)

Source: Field survey, 2001

Note:- Figures in brackets indicate percentage to the total

The table 4.9 indicates that about 56 percent of total farmer borrowers agreed that they had not received credit from formal institutions in time and in adequate amount. The supply fell short of their requirements. On the other hand, only 32 percent of the total farmer borrowers agreed to have received credit in time and in adequate amount. During the survey it was reported that majority of the medium and large farmers were able to receive credit in time and in adequate quantity. Majority of the marginal farmers were not able to get the formal credit timely and adequately due to the lack of security to offer to get loans. The table 4.9 also indicates that the proportion of farmer borrowers is increasing from low developed area to developed area implying that the availability of formal credit institutions is more in developed area than in moderately and low developed area.

With regard to the difficulties faced for receiving credit, 52 (23.11 %) farmer borrowers out of total conceded to have received credit after paying several visiting to banks.

Rate of Interest on Agricultural Loans

The objective behind supplying credit to farm sector is to enable the farmer borrowers to receive credit at a cheap and moderate rate of interest. On the contrary some of the farmer borrowers had the feeling that the prevailing rate of interest was unhelpful in nature. The response of the farmer borrowers on the issue of rate of interest is shown in table 4.10

Table 4.10: Rate of Interest on Agricultural Loans

Farmers	R.I. is cheap and moderate	R.I. is neither cheap nor moderate	Indifferent	Total
Marginal	42(77.78)	8(14.81)	4(7.41)	54(100)
Small	92(72.0)	24(32.0)	10 (7.94)	126(100)
Medium and large	16 (35.56)	24 (53.33)	5(11.11)	45(100)
All	150(66.67)	56 (24.89)	19 (8.44)	225(100)

Source: Field survey, 2001

Note: Figures in brackets indicate percentage to the total; R.I. = Rate of interset

The table 4.10 indicates that nearly 66.67 percent of the total farmer borrowers responded that the prevailing rate of interest was cheap and moderate. On the other hand, 24.89 percent of the total respondents viewed that the rate of interest on agricultural loans was neither cheap nor moderate. The remaining 8.44 percent of the total farmer borrowers had no answer to this vital problem.

It is interesting to examine here that the prevailing rate of interest charged by banks was cheap and moderate to 77.78 percent of the marginal farmers. During the survey the marginal farmers reported that the rate of interest charged by the moneylenders ranged from 36 percent to 60 percent per annum. Majority of the marginal farmers borrow from moneylenders due to the lack of collateral. The rate of interest charged by the banks ranged from 14 to 16 percent. When they compare the rate of interest of moneylenders with the rate of banks, they feel the rate charged by banks to be very low. But, majority of the medium and large farmers borrow from the banks and they gave the view that the bank rate is still higher and should still be reduced to increase the profitability of their investments. During the survey marginal and small farmers reported that many medium and large farmers borrow from the

banks for undertaking agricultural operations, but they lend the borrowed money to the marginal and small farmers at a higher rate of interest than they are charged by the banks.

Repayment of Loans

Farmer borrowers who have received credit are required to repay the loan in time. About 185 farmer borrowers i.e., 82.22 percent of the total farmers maintained that they were aware of this problem and were serious about this matter. Only 30 farmer borrowers i.e., 13.33 percent were not aware of this problem and did not take the matter seriously. The remaining farmer borrowers had no answer on this issue.

With regard to the difficulties faced by the farmer borrowers repaying the loan, they mentioned the following factors. This is shown in table 4.11

Table 4.11: Factors Accounting for Poor Repayment of Loans

Area	Drought condition	Low income	Diversion of loan for other purposes	Govt. policy of exemptions	No reply	Total
LDA	10 (13.33)	17(22.67)	41(54.67)	4(5.33)	3(4.0)	75(100)
MDA	8(10.67)	12(16.0)	36(48.0)	14(18.67)	5(6.67)	75(100)
DA	4(5.33)	10(13.33)	32(36.0)	26(22.67)	3(1.33)	75(100)
All	22(9.78)	39(17.33)	109(48.44)	44(19.56)	11(4.89)	225 (100)

Source: Field survey, 2001

Note: Figures in brackets indicate percentage to the total

It is seen from the table 4.11that 9.78 percent of the total farmer borrowers mentioned that continuous drought affecting production of crops as one of the factors for poor repayment of loan. On the other hand nearly 17.33 percent of the total mentioned that they had not repaid the loan due to low income. About 48.44 percent of the total could not repay due to the use of credit for purposes other than agricultural production. In this connection they mentioned about the repayment of old loans, marriage of daughters, repairs of houses and consumption purposes as the proximate causes for the diversion. As against them, 19.56 percent of the total borrowers frankly confessed that they had not repaid the loan on the anticipation that the government would exempt them from repayment of past dues. The remaining 4.89 percent of total farmer borrowers had no answer on this issue.

Processing of Loan Proposal

In Nepal, institutional lending agencies take much time in sanctioning of the loan after getting loan applications. There is every possibility that the sanction of loan would be delayed because of many complications. For example, loan applications are not normally called for in every season, unless the borrowers desire to obtain loan for his season requirements. Applications for loan are called generally within a short span of time, before the sowing operations. In quite a few cases the farmers have no knowledge about the basic and condition of the loans such as rate of interest, undue loan repayment punishment and other related conditions.

During the interviews conducted with selected farmers in Morang district most of the farmers were of the opinion that the institutional agencies took 16 to 20 days, to clear their applications while the final approval of loan took 17 to 90 days in case of the *Rastriya Banjiya* Bank branches.

It indicates that the branches of these mentioned three banks take more time in processing the loan applications. The farmers do not wait for such a long time. Ultimately they have to go to the private moneylenders for meeting their seasonal credit requirements.

It is significant to note that during the survey some farmers reported that they had to pay extra charges for processing the loan applications. It has been reported that they have to pay 3 per cent to the site engineer and 2 per cent to the manager of the bank of the total amount disbursed. This amount is fixed in percentage of the total disturbed amount to the farmers. It creates many problems such as the feasibility and profitability of loan.

Problem of Agricultural Marketing

About 58.5 percent of the total farmer borrowers pointed out that they had faced difficulties in marketing their products on account of lack of opportunities. Among them, lack of roads, absence of transport and communication network, distance to urban markets, payment of various commissions and charges in outside markets, and dearth of finance etc, are some of the factors preventing marketing scope in rural areas. On the other hand, 28.9 percent of the total farmer borrowers confirmed that poor marketing opportunities are due to the absence of governmental help and patronage. About 11.4 percent of the total cited several other reasons for low demand of their products, which affected their marketing prospects. Among them,

inferior quality of products, defecting handling and packing were the most important. The remaining 1.2 percent of the farmer borrowers had no answer to the problem of agricultural marketing.

4.7.2 Problems Encountered by Rural Credit Branches in the Sampled Area

The bank officials working in bank branches were also interviewed to understand their problems at the grass-root level. The bank offices operating in the three areas are: Agricultural Development Bank, Indrapur Branch, Rastriya Banijaya Bank Karsia, Branch and Nepal Bank Limited, Biratnagar, Old Airport. The views Collected through opinion survey are presented below.

Almost all the bank officials operating in the areas complained about poor recovery of loans. This is shown in table 4.12

Table 4.12: Recovery of Loans from Farmer Borrowers According to Size Class of Holdings

(In Percent)

Size Class	ADB/N	RBB	NBL	All banks
Marginal	30	32.5	36.4	32.97
Small	42	40.0	38.0	40.0
Medium and large	28.4	26.5	27.5	27.47
All	33.47	33.0	33.47	33.31

Source: Respective bank branches, July 15, 2002.

The table 4.12 shows that from marginal and small farmers the amount recovered by banks are 32.97 percent and 40 percent respectively. Recovery from medium and large farmers is 27.47 percent. Bank wise there is no significant difference in the recovery rate of all the bank branches. From the table 4.12 we see that the repayment rate of small farmers is higher than that of marginal and medium and large farmers. It is clear from the table 4.12 that the recovery rate from medium and large farmers is poorer than the recovery rate from small and marginal farmers.

Bank officials are of the opinion that continuous drought accompanied by poor income generation of farmers in low developed area of Morang district was the main cause for non–repayment of loan by farmers. Almost all the banks admitted their failure in undertaking supervision and follow up action for effective monitoring of the use and recovery of loans due to dearth of field level staff in branches.

The bank officials also gave their opinion that they are often faced with the problem of proper identification of the economic status of the borrowers. According to them, those farmers who have other sources of income are having small pieces of land in villages avail the benefits of the various schemes which are designed for the welfare of the poor section of the community.

According to the bank officials, one of the major problems, which has emerged out of the implementation of the multi-agency approach, is the lack of co-ordination among different credit institutions, extension services and development agencies.

In view of this potential and personal working experience, the respondent bank managers were also asked to provide suggestions on how rural banking services might be improved. The managers of all the selected branches give highest importance to institutional development, which can be implemented administratively. All branch managers accept the need for better staff deployment.

4.8 Major Issues in the Rural Financial Sector of Nepal

On the basis of the analysis made above we can state the major issues in the rural financial sector of Nepal point wise as the following:

- Limited outreach.
- Poor operational and financial performance
- Predominance of informal sector.
- High Transaction Costs.
- Weak financial viability and sustainability.
- Inadequate legal and regulating framework.
- High rate of growth of overdues
- Problem of co-ordination.
- Problem of proper Identification of borrowers.
- Neglect of low developed areas.
- Lack of infrastructure facilities.
- Lack of trained and competent staff in the banking sector