Demand Study on MSME Financing

Submitted to: UKaid Sakchyam Access to Finance Programme

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### Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>AGS</td>
<td>Agro-dealers Guarantee Scheme</td>
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<tr>
<td>BFIs</td>
<td>Banks and Financial Institutions</td>
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<tr>
<td>CGC</td>
<td>Credit Guarantee Corporation</td>
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<tr>
<td>CGS</td>
<td>Credit Guarantee Schemes</td>
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<tr>
<td>CGTMSE</td>
<td>Credit Guarantee Fund Scheme for Micro and Small Enterprises</td>
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<tr>
<td>CNI</td>
<td>Confederation of Nepalese Industries</td>
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<tr>
<td>CRO</td>
<td>Company Registrar Office</td>
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<td>DCGF</td>
<td>Deposit Credit Guarantee Fund</td>
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<tr>
<td>DFID</td>
<td>Department of International Development</td>
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<tr>
<td>DOCSI</td>
<td>Department of Cottage and Small Industries</td>
</tr>
<tr>
<td>DOI</td>
<td>Department of Industry</td>
</tr>
<tr>
<td>FNCCI</td>
<td>Federation of Nepalese Chambers of Commerce and Industry</td>
</tr>
<tr>
<td>FY</td>
<td>Fiscal Year</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>IFC</td>
<td>International Financial Corporation</td>
</tr>
<tr>
<td>IT</td>
<td>Information Technology</td>
</tr>
<tr>
<td>KII</td>
<td>Key Informant Interview</td>
</tr>
<tr>
<td>KODIT</td>
<td>Korea Credit Guarantee Fund</td>
</tr>
<tr>
<td>MEDEP</td>
<td>Micro Enterprise Development Project</td>
</tr>
<tr>
<td>MFI</td>
<td>Micro-finance Institutions</td>
</tr>
<tr>
<td>MOI</td>
<td>Ministry of Industry</td>
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<tr>
<td>MSMEs</td>
<td>Micro, Small and Medium Enterprises</td>
</tr>
<tr>
<td>MSMED</td>
<td>Micro, Small and Medium Enterprises Development</td>
</tr>
<tr>
<td>NPR</td>
<td>Nepali Rupees</td>
</tr>
<tr>
<td>NRB</td>
<td>Nepal Rastra Bank</td>
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<tr>
<td>SMEs</td>
<td>Small and Medium Enterprises</td>
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<tr>
<td>USD</td>
<td>United States Dollar</td>
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Executive Summary
This study aims to provide the total formal credit demand and estimate the financing gap in the Micro Small and Medium Enterprise (MSME) sector in Nepal. Finally, it explores potential interventions to address the lack of access to formal finance for MSMEs.

MSME Overview

MSMEs are a vital component of Nepal’s economy. “It is estimated that MSMEs employ 1.75 million people and account for 22% of Gross Domestic Product (GDP) in Nepal”. Despite the importance of MSMEs to Nepal’s economy, many MSMEs lack access to affordable and suitable formal financial services forcing them to borrow from informal sources or restrict their business growth. Lack of collateral, inadequate book keeping and lack of documentation are some of the factors limiting access to formal credit, further, formal financial institutions are reluctant to extend credit to MSMEs because of higher transaction cost and associated risk.

Total Credit Demand in the MSME Sector

The total formal credit demand of the MSME sector has been computed to be NPR 1,043 billion (USD 9.5 billion); the average formal credit demand per MSME is NPR 5 million (USD 45,391). Since only 72% of surveyed MSMEs have indicated that they require finance from the financial institutions, meaning 28% MSMEs do not require credit for their business thus, the total credit demand has been extrapolated based on the credit demand indicated by 72% MSMEs only. The findings also closely echo with the World Bank’s estimate as well. As per the World Bank enterprise survey (2013), the percentage of firms not needing a credit in “all countries” is 46.4%, “South Asia” is 44.7% and “Nepal” is 36.1%.

The demand for credit is highest in the small enterprise segment. The total credit requirement of a small enterprise (46%) is estimated to be NPR 478 billion (4.3 billion). Like small enterprise, micro enterprise also mostly operate in agriculture, service and manufacturing and have a significant demand for working capital. In fact, the findings suggest that 40% of the credit demand amounting to NPR 418 billion (USD 3.7 billion) is from micro enterprises.

The findings of the survey conclude that the demand for formal credit is highest in province no. 5 (34%) with NPR 356 billion (USD 3.2 billion) followed by province no. 1 (24%) with total credit demand of NPR 250.40 (USD 2.2 billion). Similarly, province no. 3 (20%) has a total credit demand of NPR 210.5 billion (USD 1.9 billion). As expected, the demand is lowest in province nos. 6 and 7 with 1% and 2% respectively of the total formal credit demand.

Flow of Finance to the MSME Sector

Despite the established definition of credit to the SME sector outlined by the central bank, the definition of “credit to the MSME sector” is unique in each financial institution. Moreover, BFIs are not required to publish their credit portfolio towards the MSME sector separately, therefore the actual credit towards the MSME sector by BFIs is not available. Nonetheless, our supply side interviews with

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2 Since significant number of MSMEs are also registered with CRO and local municipalities, the total number of MSMEs operating in Nepal and the demand for the formal credit would be much higher. For instance the IFC has estimated 1.3 million MSMEs operating in Nepal.
key stakeholders suggest that “on an average BFIs credit towards the MSMEs sector is between 20 to 30% of their total credit portfolio”.

Based on the first approach (overall BFIs), considering the latest statistical report of Nepal Rastra Bank\(^3\), the total credit portfolio of BFIs is NPR 2.4 trillion (USD 21.7 billion) therefore, considering that the total credit towards the MSMEs is 25%\(^4\), the total supply of credit towards the MSME sector is NPR 605 billion (USD 5.4 billion). Likewise, based on the second approach (commercial banks only), the total credit portfolio of commercial banks is NPR 2.1 trillion (USD 19 billion). Given the information, the total supply of credit towards the MSME sector is NPR 527 billion (USD 4.7 billion).

**MSME Credit Gap**

The total formal credit gap considering the first approach—the total formal credit gap is NPR 438 billion (USD 3.9 billion) in contrary, considering the second approach, the total formal credit gap is NPR 516 billion (USD 4.6 billion).

The national GDP grew by 6.3% to NPR 3 trillion (USD 27.2 billion) in the FY 2017/18. If we consider the first approach, the total credit gap to GDP ratio stands at 14.3%. Likewise the ratio is 17% considering the second approach. The total formal credit gap to the MSME sector also reflects with international standards, the findings from IFC also suggest that the credit gap in formal MSMEs sector in developing countries is equivalent to 19% of GDP\(^5\).

**Way Forward**

The overall assessment of demand and supply side study indicates the presence of a significant gap on the supply of formal credit to the MSME sector in Nepal. The credit gap in the sector is a combined result of demand-side challenges such as legal structure of MSMEs, lack of collateral, as well as supply-side gaps, such as, lack of credit products focused on MSMEs and centralized credit appraisal. Due to the gap, a significant number of MSMEs use own funds or borrow from informal providers, such as, families and friends, to finance their business as they lack collateral and documents. As a result, they are required to pay higher interest rates for shorter periods of time which thereby limits their business activity. This indicates a missed opportunity and potentially inefficient financial intermediation which points out a major gap between demand and supply of financial services for MSMEs.

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\(^3\) Monthly Statistical Report, July 2018, Nepal Rastra Bank

\(^4\) We have considered mean value of 25% as a benchmark to calculate supply of funds

1. Background of the Study

Micro, Small and Medium Sized Enterprises (MSMEs) are a vital component of Nepal’s economy. It is estimated that MSMEs employ 1.75 million people and account for 22% of Gross Domestic Product (GDP) in Nepal.\(^6\) Despite the importance of MSMEs to Nepal’s economy, many MSMEs lack access to affordable and suitable financial services, forcing them to borrow from informal sources or restrict their business growth. Improved access to finance is essential for scaling up and expansion of these MSMEs.

As per published data, MSMEs represent only 2.6% of total commercial lending in Nepal\(^7\) Although Nepal Rastra Bank (NRB) allows BFIs to extend credits against movable assets, immovable assets, cash flow based, fixed accounts or other acceptable guarantees, in practice, BFIs show preference for physical collateral especially land and buildings. As of mid-July 2018, 61.7% of total credits and advances extended by banks were secured through collaterals of land and buildings and 14.4% through collaterals of current assets. Since small businesses rarely own immovable assets to secure credits, their ability to access credit is restricted. Although NRB allows Class A banks to extend personal credit of up to NPR 1.5 million (USD 13,614) without collaterals, they require banks to have additional credits loss provisions of 20% on such credits, with only few exceptions as per an NRB directive\(^8\). This requirement further discourages banks from providing credits without collaterals. Furthermore, BFIs quote higher interest rates on non-collateral credits as there is relatively ‘higher risk’ associated with them.

NRB through its Monetary Policy for fiscal year 2017/18 has increased the productive sector lending of “A” class Commercial banks to 25% of their credit portfolio from 20% in the previous year. This includes sectors such as Agriculture, Energy, Tourism and others including small and micro enterprises. However, as shown in the Table 1, commercial banks struggle to meet the directed productive sector-lending requirements.

Table 1: Productive Sector Lending Requirement and Actual Lending by the Commercial Banks

<table>
<thead>
<tr>
<th>Sector</th>
<th>Regulatory Requirement FY 2016/17</th>
<th>Actual Lending by Banks FY 2016/17</th>
<th>Regulatory Requirement FY 2017/18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>15.00%</td>
<td>7.10%</td>
<td>10.00%</td>
</tr>
<tr>
<td>Energy</td>
<td>3.00%</td>
<td></td>
<td>5.00%</td>
</tr>
<tr>
<td>Tourism</td>
<td>5.00%</td>
<td>3.30%</td>
<td>5.00%</td>
</tr>
<tr>
<td>Others including small and micro enterprises</td>
<td>3.90%</td>
<td></td>
<td>5.00%</td>
</tr>
<tr>
<td>Total</td>
<td>20.00%</td>
<td>17.30%</td>
<td>25.00%</td>
</tr>
</tbody>
</table>

Source: NRB as of Mid-May 2017.

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\(^7\) Mid-November 2015, Nepal Rastra Bank

\(^8\) Clause 9.5, Unified Directive 2018, Nepal Rastra Bank
Commercial banks tend to be reluctant to extend credits to MSMEs because of higher transaction costs and associated risks in working with MSMEs, as they lack adequate collateral, required documentation and proper accounting systems. From our experience of working in access to finance for MSMEs, the following characteristics of MSMEs act as key constraints for BFIs to extend credits to them:

1. Lack of collateral
2. Absence of books of accounts
3. Informal and unorganized sector
4. Non-compliance of secretarial and statutory requirements (including auditing)
5. Small capital size
6. High cost of servicing

In light of this, and to increase expansion of credit to the MSME sector, the availability of a Credit Guarantee Scheme (CGS)—which provides third-party credit risk mitigation to lenders—is an attractive option to unlock access to finance for MSMEs. UKAid Sakchyam Access to Finance Programme (Sakchyam) has been leading efforts to institutionalize and scale CGS in Nepal. In a report disseminated in December 2017, Sakchyam presented case studies of CGSs from eight different countries and highlighted best practices in designing and implementing CGSs. The report was subsequently used as the basis for a multi-stakeholder workshop, “Developing a Robust MSME Credit Guarantee Facility: Unleashing Access to MSME Finance in Nepal”, which was followed by identification of potential CGS operating models for Nepal.

To determine the feasibility of a CGS in Nepal, it is important to estimate the demand for such a facility. The analysis of key characteristics of the MSME market such as; number of MSMEs, size, sector, geographic concentration and financing needs are helpful in making informed decisions on designs of CGS in Nepal.

2. Scope of Work

Sakchyam sought to conduct a feasibility study to take an in-depth look at: the market demand, an institutional assessment of Deposit and Credit Guarantee Fund, comparison of models and a legal review as a step forward to institutionalize and scale credit guarantee schemes in Nepal.

Existing demand studies on financial inclusion in Nepal lack an in-depth understanding of MSMEs and their formal credit needs. In designing a CGS for Nepal, it is critical to quantify overall demand for formal credit by MSMEs and obtain a better understanding of specific target markets and product needs. In this context, the Sakchyam demand study has two main objectives:

1. Mapping MSME formal credit demand to inform the design of future credit guarantee schemes; and
2. Estimating the MSME financing gap.

Objective 1: Mapping MSME Formal Credit Demand: Demand for formal credit, funding needs and specific products will differ depending on the size, sector and location of MSMEs, therefore, proper market segmentation is a helpful way of determining the type of enterprise, sector and location where unmet demand for credit is most urgent.

Clarifying Definitions of MSMEs: This was the first step in selecting segmentation criteria as it required clarification in definition of MSMEs and identification of the number of businesses, sectoral composition, financing requirements, access to collaterals and formal credit requirements for each. Common criteria used to differentiate micro, small and medium enterprises are number of employees, sales turnover and asset size. The Industrial Enterprise Act 2016 of Nepal classifies MSMEs based on number of employees and fixed assets into five categories: micro, cottage, small, medium and large
industry. NRB defines Small and Medium Enterprises (SMEs) based on ‘paid-up capital’ and ‘fixed assets’. In practice, however, BFIs tend to differentiate micro, small and medium enterprises by credit size which has complicated the definition of MSMEs and made it difficult to determine the actual credit-financing gap for these enterprises.

Thus, as part of the demand study it was important to clarify appropriate MSME definitions based on clear criteria which is practical for the purpose of segmentation. Besides segregating enterprises based on their size into micro, small and medium categories, it was useful to segregate enterprises based on their potential for growth. For example, MFI graduates are high-performing micro businesses with high growth potential but limited access to financial services as they are often too large for micro financial institutions and too small or too risky, for regular banks and private equity firms. As such, they represent a promising target market for credit guarantee facilities.

Similarly, recent literature has distinguished between "subsistence" and "transformative" enterprises. Subsistence enterprises are small operations that do not grow into large firms but merely provide an alternative employment opportunity to the entrepreneur and potentially their family members. Transformative enterprises, on the other hand, are distinguished by their willingness to innovate and take risks, as well as a proactive attitude in exploiting emerging market opportunities. Transformative enterprises, so-called "gazelles" have been found to have a disproportionate (to employment and capital investment) impact on value addition and job creation. As such, transformative enterprises are a highly promising target market for credit guarantee facilities.

A clear criteria was necessary to form a target market segmentation, therefore a MSME definition was created for this study in close collaboration with Sakchyam.

**Sectoral Composition:** As a part of the demand study, it was essential to determine the sectors MSMEs typically operate in as well as the promising sectors for MSME. This informed the design of CGS by shedding light on specific financial needs and requirements and reasons for restricted access to credit for particular sectors.

MSMEs typically operate in the manufacturing, service or agriculture sectors. The Industrial Enterprise Act 2016 has classified industries into eight categories based on the nature of their activity: energy, manufacturing, agro & forest, mineral, construction, tourism, information transmission & communications and service based industry. Based on data from the Department of Industries and other sectoral research, Table 1 shows the selected sectoral composition for this exercise.

<table>
<thead>
<tr>
<th>S No.</th>
<th>Industry Sector</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Agro and Forestry</td>
<td>Farming, Livestock</td>
</tr>
<tr>
<td>2</td>
<td>Manufacturing</td>
<td>Textile, Processing</td>
</tr>
<tr>
<td>3</td>
<td>Service</td>
<td>Tourism, Wholesaler &amp; Retailer, Transport,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Handicrafts</td>
</tr>
<tr>
<td>4</td>
<td>Tourism</td>
<td>Restaurants, Home-stays, Hotels, Tour Operator</td>
</tr>
</tbody>
</table>

The sectoral segmentation of MSMEs was expected to help clarify the CGS’s overall mission statement and determine whether to extend guarantees to either a broad or narrow target and ultimately better inform the various design features of a CGS. Sectors and industry types were established in close collaboration with Sakchyam’s team.

**Regional Distribution and Urban/Semi-Urban/Rural Breakdown:** Nepal’s geographical variation has had an impact on MSME distribution throughout the country. Generally, small and medium firms are located in urban or semi-urban areas. The majority of firms in rural areas tend to be micro enterprises, which are essentially family businesses. The survey covered MSMEs operating in each of Nepal’s seven provinces across all ecological regions (i.e. Hills, Mountain and Terai) and gave urban, semi-urban and rural breakdowns of the financing gaps. This contributed to establishing CGS mission statements and target markets.

**Objective 2: Estimating the MSME Financing Gap**

To benefit optimal design of a CGS, the demand study aimed to deliver an accurate estimate of MSME financing gaps. Although it was not possible to precisely quantify the demand and supply of credit for MSMEs in Nepal, better approximations of the total value gap in credit financing have been extrapolated from the results of surveys.

<table>
<thead>
<tr>
<th>Industry Sector and Type</th>
<th>MSME Survey</th>
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<tbody>
<tr>
<td></td>
<td>Micro</td>
</tr>
<tr>
<td></td>
<td>7 Province</td>
</tr>
<tr>
<td>Terai</td>
<td>Hill</td>
</tr>
<tr>
<td>Urban</td>
<td>Semi-Urban</td>
</tr>
</tbody>
</table>
3. Definitions of MSMEs

MSMEs have varied definitions globally and locally in the context of Nepal. The Central Banks of different countries around the world follow a particular description of MSME, whereas the international financial institutions have their own explanation as to what an MSME is. In the context of Nepal, NRB has followed a set of criteria to define MSME, which has not been followed by the commercial banks of Nepal. They have established individual definitions of MSMEs for their practice. Due to this diversity in the definition of MSMEs, this study created a separate description of MSMEs (amalgamating the different criteria's and on the ground usage) for segmentation of the target market. This section will lay out criteria of defining MSMEs in few countries and international financial institutions, followed by the MSME definitions established in the context of Nepal and for this study.

3.1 Definitions around the World

Numerous parameters are considered in order to explain MSMEs. In case of the International Finance Corporation (IFC) - MSME is defined on the basis of number of employees, total assets, and annual sales as indicators to categorize enterprises. For instance, enterprises with less than 10 employees, $0.1 million asset value and annual sales respectively are considered micro enterprise under IFC’s definition. Detailed definition can be found in Appendix 1. The criteria that European Union (EU) follows to define SMEs include: staff headcount and turnover/balance sheet amount. Under this definition, an enterprise with less than 10 employees, €2 million turnover or balance sheet is classified as a micro enterprise. Comprehensive definition set by EU is available in Appendix 2.

In India MSMEs are defined on the basis of sectors (manufacturing and services) and investment in plant and machinery. Under this plan, a micro enterprise in manufacturing sector could have investment up to IR (Indian Rupee) 2.5 million in plant and machinery while a micro enterprise in service sector could have investment not exceeding IR 1 million. In February 2018, the Indian Cabinet approved a proposal to define enterprises on the basis of annual sales turnover instead, but it is yet to be implemented. More details on the Micro, Small and Medium Enterprises Development (MSMED) Act 2006 and definition of MSMEs on the basis of annual sales turnover is available in Appendix 3.

In the case of Bangladesh, the categorization is based on the company’s fixed assets (other than land and buildings) and employed manpower. Moreover, considered companies cannot be publicly traded. For example, a small business in the service sector cannot employ manpower above 25 and must possess assets within the range of 50,000 to 5 million Taka. Complete definition of MSMEs is available in Appendix 4.

3.2 Definitions of MSMEs in Nepal

In the context of Nepal, under the Industrial Enterprise Act 2016, industries are classified into micro, cottage, small, medium and large enterprises on the basis of the number of employees and their fixed assets. For micro industry, the thresholds for employee, financial transaction, and fixed assets are: NPR 5 million, and NPR 500,000 respectively. Likewise, energy consumption cannot exceed 20KV for micro industry. However, NRB employs a different definition. It uses paid-up capital and fixed assets to determine if the company can be considered small or medium enterprise. Specifically, paid-up capital should not exceed NPR 5 million and fixed assets should be below NPR 50 million. The classification of industry as per Industrial Enterprise Act and definition of SME as per NRB is listed in Appendix 5.

3.2.1 MSME Landscape in Nepal

The Department of Industries (DOI) and The Department of Small and Cottage Industries (DOCSI) under Ministry of Industry (MOI) are the two major departments which register MSMEs in Nepal (Table 3 presents the categories of industries which are registered under DOCSI and DOI). Besides these two bodies, some of the MSMEs are registered in Company Registrar Office (CRO) and local
municipalities. Informal MSMEs comprise a large section of Nepal’s economy; these are neither registered under the above bodies nor do they comply with the auditing practices.

Table 3: Categories of Industries Registered under DOCSI and DOI

<table>
<thead>
<tr>
<th>Category</th>
<th>Number</th>
<th>Registration Body</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro, Cottage and Small Industries¹</td>
<td>290,459</td>
<td>DOCSI</td>
</tr>
<tr>
<td>Small Industries²</td>
<td>4,389</td>
<td>DOI</td>
</tr>
<tr>
<td>Medium Industries</td>
<td>1,563</td>
<td></td>
</tr>
<tr>
<td>Large Industries</td>
<td>952</td>
<td></td>
</tr>
</tbody>
</table>

¹ 92% of these industries are Small Industries

² 99% of small industries registered with DOI have foreign investments

3.3 Definition of MSME for this Study

Despite the definitions given by the Industrial Enterprise Act 2016 and NRB, BFIs in Nepal have a separate parameter to define MSMEs for their practice. They tend to differentiate MSMEs by the size of their credit. Owing to this diversity in definitions given to MSMEs across countries, institutions and commercial banks within Nepal, it was important to establish a description particularly for this study to segregate the target market. The MSME definition, therefore, was created in close collaboration with Sakchyam.

For this study, MSMEs are understood as those enterprises with maximum fixed assets of NPR 100 million, categorized as Small industry under Industrial Enterprise Act 2016. Micro enterprises with the potential to graduate to the next level were accommodated. In addition to the government’s definition, the samples for this study required the following characteristics/features:

- Technology savvy
- Growth oriented start ups
- Innovators
- Ground breakers
- Key actor of the value chain
- Export potential
- Import substitution
- Quality over quantity
- Customer driven
- Growth strategy
- Profitability
- Proven track record
- Risk takers
- Job creator
4. Research Methodology

The demand study has two main components: 1) Target Market (MSME) Survey, and 2) Provider Segment (Bank) Survey.

**Figure 2: Main Components of our Methodology for the Target Market Survey and the Provider**

<table>
<thead>
<tr>
<th>Methodology</th>
<th>Activities For Target Market Survey</th>
</tr>
</thead>
<tbody>
<tr>
<td>Phase I Design Process</td>
<td>Inception Meeting</td>
</tr>
<tr>
<td>Phase II Execution</td>
<td>Pilot Test</td>
</tr>
<tr>
<td>Phase III Evaluation Process</td>
<td>Compilation, Analysis and Extrapolation of Data</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Methodology</th>
<th>Activities For Provider Segment Survey</th>
</tr>
</thead>
<tbody>
<tr>
<td>Execution</td>
<td>Secondary Data Review</td>
</tr>
<tr>
<td>Evaluation</td>
<td>Estimate Financial gap</td>
</tr>
<tr>
<td>Deliverable of the Study</td>
<td>Weekly Updates</td>
</tr>
</tbody>
</table>

4.1 Target Market (MSME) Survey
The main purpose of the target market survey was to map MSME formal credit demand in order to gain an in-depth understanding of the MSME sector especially on their credit needs. Further, this study also helped to quantify overall demand for formal credit by MSMEs, specific target markets within MSME and their product needs. Clarity on these issues of MSME financing helped this study to estimate the MSME financing gap, and provided basis for the assumptions to prepare financial projections, feasibility study and a CGS business plan.

4.1.1 Sector Selection
Four major sectors: manufacturing, agro and forestry, service and tourism were selected as the primary sectors for this study. All the remaining sectors were categorized as ‘others’. The primary basis for selection of these sectors was the Industrial Enterprise Act, 2016. Moreover, the study also considered the sector segregation prescribed by NRB through its Unified Directives 2074.
These sectors were also selected on the basis of the following rationales:

- Business Growth and Scalability
- Contribution to the National GDP
- Domestic Demand
- Employment Generation
- Export Potential

### 4.1.2 Sample Selection across Sectors and Provinces (Sample Frame)

For distribution of samples across sectors and provinces, the study took averages of the contributions to the GDP and registration of industries. The methodology is discussed in detail below.

#### 4.1.2.1 Sector Samples

For the sectoral sample selection, we took an average of both Contribution of the sector to GDP and Registration of Industries at DOCSI. The individual sheets of GDP contribution and registration is available in Appendix 6 (Sector Sampling Calculation Table 1).

Based on the average figures, this study collected 21% samples from Manufacturing, 21% from Agriculture, 47% from Service, 6% from Tourism and the remaining 6% from the Others segment.

**Table 4: Sector Selection by taking Average of GDP Contribution of the Sector and Registration of Industries at DOCSI**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Weight (Sectoral Contribution to GDP as of 2016/17)</th>
<th>Sample as per GDP Presence (a)</th>
<th>Weight (On the basis of Registration with DOCSI as of FY 2016/17)</th>
<th>Sample as per registration (b)</th>
<th>Sample to be considered (Average of a and b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>6%</td>
<td>24</td>
<td>36%</td>
<td>144</td>
<td>84 (21%)</td>
</tr>
<tr>
<td>Agriculture</td>
<td>29%</td>
<td>116</td>
<td>12%</td>
<td>48</td>
<td>82(21%)</td>
</tr>
<tr>
<td>Service</td>
<td>56%</td>
<td>224</td>
<td>38%</td>
<td>152</td>
<td>188(47%)</td>
</tr>
<tr>
<td>Tourism</td>
<td>2%</td>
<td>8</td>
<td>10%</td>
<td>40</td>
<td>24(6%)</td>
</tr>
<tr>
<td>Others</td>
<td>7%</td>
<td>28</td>
<td>4%</td>
<td>16</td>
<td>22(6%)</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>400</td>
</tr>
</tbody>
</table>

#### 4.1.2.2 Provincial Segregation of Samples

For the distribution of samples across provinces, the same methodology was adopted to derive sample distribution across sectors. The individual sheets of contribution to GDP of Provinces and registration of industries under each province is available in Appendix 7.

As per the average calculation shown in the tables below,

- a total of 63 samples were collected from Province 1,
- 60 from Province 2,
- 137 from Province 3,
- 37 from Province 4,
- 64 from Province 5,
- 14 from Province 6, and
- 25 from Province 7.
Table 5: Sample Selection across Provinces by taking Average of Contribution to GDP and MSMEs Registration with DOCSI

<table>
<thead>
<tr>
<th>Province</th>
<th>GDP Contribution</th>
<th>Sample based on GDP Contribution (a)</th>
<th>Percentage of Registered MSMEs</th>
<th>Sample based on registration (b)</th>
<th>Sample to be considered (Average of a and b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>17%</td>
<td>70</td>
<td>14%</td>
<td>57</td>
<td>63</td>
</tr>
<tr>
<td>2</td>
<td>16%</td>
<td>65</td>
<td>14%</td>
<td>54</td>
<td>60</td>
</tr>
<tr>
<td>3</td>
<td>32%</td>
<td>128</td>
<td>37%</td>
<td>147</td>
<td>137</td>
</tr>
<tr>
<td>4</td>
<td>10%</td>
<td>38</td>
<td>9%</td>
<td>37</td>
<td>37</td>
</tr>
<tr>
<td>5</td>
<td>15%</td>
<td>61</td>
<td>17%</td>
<td>67</td>
<td>64</td>
</tr>
<tr>
<td>6</td>
<td>3%</td>
<td>13</td>
<td>4%</td>
<td>14</td>
<td>14</td>
</tr>
<tr>
<td>7</td>
<td>6%</td>
<td>25</td>
<td>6%</td>
<td>24</td>
<td>25</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>400</td>
<td>400</td>
<td>400</td>
<td>400</td>
</tr>
</tbody>
</table>

4.1.2.3 Distribution of Samples across Sectors and Provinces

Based on the segregation of sample based on sector and province, the following samples would be selected from each of the provinces. For instance, out of 400 samples: 63 samples would be selected from province 1, out of which 13 of them will be from the manufacturing sector, 13 from agriculture sector, 30 from service sector, 4 from tourism sector and 3 from ‘others’ sector.

Table 6: Distribution of Samples across Sectors and Provinces

<table>
<thead>
<tr>
<th>Province Segregation</th>
<th>Ratio*</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>21%</td>
<td>13</td>
<td>13</td>
<td>29</td>
<td>8</td>
<td>13</td>
<td>3</td>
<td>5</td>
<td>84</td>
</tr>
<tr>
<td>Agriculture</td>
<td>21%</td>
<td>13</td>
<td>12</td>
<td>28</td>
<td>8</td>
<td>13</td>
<td>3</td>
<td>5</td>
<td>82</td>
</tr>
<tr>
<td>Service</td>
<td>47%</td>
<td>30</td>
<td>28</td>
<td>65</td>
<td>18</td>
<td>30</td>
<td>6</td>
<td>12</td>
<td>188</td>
</tr>
<tr>
<td>Tourism</td>
<td>6%</td>
<td>4</td>
<td>4</td>
<td>8</td>
<td>2</td>
<td>4</td>
<td>1</td>
<td>1</td>
<td>24</td>
</tr>
<tr>
<td>Others</td>
<td>6%</td>
<td>3</td>
<td>3</td>
<td>8</td>
<td>2</td>
<td>4</td>
<td>1</td>
<td>1</td>
<td>22</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>63</td>
<td>60</td>
<td>137</td>
<td>37</td>
<td>64</td>
<td>14</td>
<td>25</td>
<td>400</td>
</tr>
</tbody>
</table>

* Note: The ratio is same as determined in Section 3 i.e. average of registration and GDP contribution to the respective sectors.

4.1.2.4 Districts for Sampling under Each Province

31 districts were identified on the basis of economic activities, registered entities and economic centers for this study. Table 6 presents the districts (21) selected for this study.
Table 7: List of Selected Districts for the Study.

<table>
<thead>
<tr>
<th>Province</th>
<th>Terai (16)</th>
<th>Hills (13)</th>
<th>Mountain (2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Jhapa, Morang (Biratnagar), Sunsari</td>
<td>Illam</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Birgun (Corridor), Janakpur, Mohottari (Bardibas), Siraha</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Chitwan (Bharatpur Corridor)</td>
<td>Kathmandu Valley, Kavre, Makwanpur (Hetauda)</td>
<td>Dhading</td>
</tr>
<tr>
<td>4</td>
<td></td>
<td>Kaski (Pokhara), Lamjung, Tanahun</td>
<td>Gorkha</td>
</tr>
<tr>
<td>5</td>
<td>Banke (Nepalgunj), Dang, Kapilbastu (Bhairahawa), Nawalparasi (corridor), Rupandehi (Butwal)</td>
<td>Palpa</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td></td>
<td>Dailekh, Salyan, Surkhet</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Kanchanpur (Dhangadi, Tikapur), Kailali (Mahendranagar)</td>
<td>Dadeldhura</td>
<td></td>
</tr>
</tbody>
</table>

These districts were selected based on the following criteria:

1. Highest number of registered enterprises under these districts
2. Growing economic activities
3. Provincial capitals and economic centers
4. Key districts used by NRB to produce yearly economic activities report
5. Key and upcoming economic centers of each province
6. Considering urban and semi urban setting

Note: Considering the low presence of MSMEs in rural areas they have not been looked into.

4.1.2.5 Sources for Sample Selection and Process

The field survey team (Rooster Logic) deployed its enumerators to the respective districts in each Province under the supervision of the coordinator. The team identified the MSMEs whose traits matched with the established definition of MSME. Out of 400 samples, 120 were selected from various non-traditional sources while the remaining 280 samples were selected from respective provinces and districts. The sources of sample selection are explained below:

1. Traditional Sources

The team coordinated with respective district and provincial offices of Department of Industry and DOCSI. They also collaborated with the local business groups such as, Federation of Nepalese Cottage and Small Industries, Regional offices of Federation of Nepalese Chambers of Commerce and Industry (FNCCI), Confederation of Nepalese Industries (CNI) and other respective associations to identify prospective samples.
2. Non-traditional Sources

Some of the non-traditional sources for the selection of the samples were:

1. Nepal Entrepreneurs Hub
2. Entrepreneurs for Nepal
3. Business Accelerator Programs
4. Private Equity Firms
5. MEDEP Graduates
6. Nepalese Young Entrepreneurs Forum
7. Others

4.1.2.7 Questionnaire for the Survey

A questionnaire was developed to enquire with the MSMEs for covering the demand side’s perspectives. The complete questionnaire is available in Appendix 8.

4.1.3 Provider Segment (Supply Side) Study

The main purpose of the provider segment study is to share perspectives of the supply side in working with MSMEs and highlight probable opportunities and challenges for BFIs while scaling the CGS. Based on the criteria given below, eight commercial banks were selected for the survey. The list of banks which participated in the survey are given in Appendix 9.

4.1.3.1 Provider Segment Survey

The study has used Provider Segment Survey to cross verify the quantitative data from the Target Market study, providing a holistic picture of the MSME financing landscape. The key respondents of the supply-side survey were BFIs affiliated with NRB.

4.1.3.2 Selection of Banks for the Survey

The Banks for the provider segment survey were selected based on the following criteria.

- Paid up capital and reserves
- Number of years in operation
- Number of branches
- Distribution of assets and liabilities
- Total credit classified by sector
- Base rate, NPL ratio and profitability

4.1.3.3 Questionnaire for the Survey

A personal interview questionnaire was prepared to cover the perspectives of provider segment. The complete questionnaire is available in Appendix 10.

4.3 Limitation of the Study

- Due to unavailability of data of registered MSMEs with other government entities such as, Municipalities and CRO, the study has only considered MSMEs registered with DOCSI.
- The non-disclosure policy of BFIs might have impacted the findings of the study.
- Due to the reluctance in sharing financial information, the findings of the national survey on indicators such as profitability, annual turnover, annual expenditure and credit size could have been underreported or exaggerated.
4.4 Methodology for Calculating Financial Gap Analysis

The data from the results of the survey was extrapolated and approximations of the total MSME gap in credit financing were estimated. The average MSME credit demand was calculated by extrapolating the result from the surveys by utilizing the official number of MSMEs. Also, the percentage of businesses requiring credits were considered and credit worthiness of the firms and actual requirement were accounted on the grounds of the findings of the study. The Supply estimates were determined by using NRB statistics and results of the provider segment study (especially with BFIs) by applying the average percentage of credits allocated to SMEs to total volume of credits in the banking system. On the basis of demand and supply estimates, MSME Finance Gaps were determined. Additionally, empirical studies were also referred to while determining the financial gaps. The detailed methodology adopted for the extrapolation the total demand according to size, province, sector and geographical specificities is available in Appendix 11.

5. Study Findings

5.1 Demand Survey Findings

As highlighted in the methodology section, the surveyed MSMEs have been stratified into sectors, province and scale of the enterprises. Moreover, to ensure adequate and complete information, 51 additional MSMEs were surveyed during the course of the national survey. Thus, this section provides key findings of the survey conducted with 451 MSMEs. The complete distribution of 451 samples across districts, sector and region is available in Appendix 12.

5.1.1 Background and Characteristics

This section describes the characteristics of the surveyed MSMEs, their location, sector and size along with legal status.

5.1.1.1 Location of the MSMEs

In terms of locational distribution of surveyed MSMEs, 34% of MSMEs are located in Province 3, 16.4% in Province 5 and 15.7% in Province 1. Among all the Provinces, Province 6 has the lowest number of surveyed MSMEs which is 3.1%.

Figure 3: Distribution of Samples across Provinces
In terms of geographical distribution, 58.7% of MSMEs are from the Terai region, 40% from the Hills and 0.44% are from the mountain region. Likewise, in terms of settings, 85% of surveyed MSMEs are located in urban areas, 12% are located in semi-urban area and 3% are from remote areas.

5.1.1.2 Sectoral Distribution of MSMEs
In terms of the sector, 47% of surveyed MSMEs are from the Service sector followed by Manufacturing (23%), Agriculture (21%), Tourism (5%) and others sector (5%). The sectoral segregation of surveyed samples are based on GDP contribution of the sector and number of registered MSMEs in the sector.

![Distribution of Samples across Sectors.](image)

Within the Others’ sector, 57% of surveyed enterprises are from Information Technology (IT) sector while the other major sectors were Engineering and Construction (28%) and Mining and Minerals (14%).

5.1.1.3 Size of MSMEs
Small enterprises dominate the MSME landscape in Nepal. 48.6% of the enterprises surveyed are categorized as Micro, while 43.2 % were found to be small, and remaining 8.2% are from Others’ category which are mainly cottage and medium scale enterprises.
Except for Province 1 and 5, all other provinces have a similar composition of MSMEs in terms of size. Province 1 has a higher number of small enterprises while Province 5 has a higher concentration of Micro enterprises.

5.1.1.4 Gender of Business Owners
The majority (80.7%) of business owners surveyed are male, across business size and sectors, only 19.3% of surveyed enterprises are operated by females. The majority of MSMEs operated by females are in the service sector (69%), followed by agriculture sector (10%).
In terms of scale of business, both Micro and Small scale enterprises are dominated by MSMEs operated by males. Over 80% of surveyed Micro and Small enterprises are promoted by males.

5.1.1.5 Legal Status of MSMEs

Nearly 63% of MSMEs are registered as a Sole Proprietorship, while 28% MSMEs are registered as a Private Limited Company, and only 8.4% of MSMEs are registered as a partnership venture.

Likewise, in terms of business registration, MSMEs in Nepal are registered with various government entities depending upon the nature of the business and their scale of operations. The major bodies registering the MSMEs are, DOCSI, DOI, Company Registrar Office (CRO) and Municipality. Moreover, for tax purposes, MSMEs are either registered under Permanent Account Number (PAN) or Value Added Tax under Inland Revenue Department.
Figure 9: Registered MSMEs.

With regards to registration with various government bodies, almost 55% of surveyed MSMEs are registered with Municipality and PAN. On a standalone basis, 78% are registered with PAN while 61% MSMEs are registered with a Municipality. Likewise, 32.99% MSMEs are registered with DOCSI, and 9.9% MSMEs are registered with DOI. Also, almost 15% surveyed MSMEs are registered with the CRO.

5.1.1.6 Ownership of Premises where MSMEs Operate

When asked about the physical ownership where their businesses operate, a majority of MSME enterprise owners explained that they operate their business from a rented premise (79%) while only one fifth (21%) of MSMEs operate from their own premise.

Figure 10: Ownership of Premises.

5.1.1.7 Export Oriented MSMEs

Only 21% of surveyed MSMEs are export oriented enterprises. Out of which, 52.7% MSMEs are small enterprises, while 27% of them are Micro enterprises.

5.1.1.8 Employment Generation

The total employment generated by the surveyed MSME is 3,344, out of which over half of them are employed by the Small enterprises (50.7%), the Micro enterprises contribute almost 35% and the Others sector contribute about 15%.
5.1.2 Finance
This section explains the interactions of MSMEs with finance from different perspectives such as maintenance of books, auditing, current usage of financial services and reasons for non-usage of financial services amongst others.

5.1.2.1 Maintenance of Financial Records and Auditing
Enterprises were asked whether they organized their finances and only 66% of MSMEs sampled have maintained their financial statements/book of accounts. Further, only 56% of the sampled enterprises audit their book of accounts. Amongst the enterprises who do not audit their financials, almost half of the surveyed MSME from the Service sector maintain audits followed by others (26.9%), and the Manufacturing (17.8%) sector.
5.1.2.2 Scale of Operations
The surveyed MSMEs were asked to share information about their

a. annual turnover/sales,
b. annual expenditure, and
c. annual profit

For ease of respondents, a closed-ended question with applicable range was provided considering the sensitivity of the question.

Almost 74% of surveyed MSME have indicated that their annual turnover is below NPR 2.5 million (USD 22,690)\(^{10}\) while 15.1% of them have an annual turnover between NPR 2.5 million (USD 22,690)-
NPR 5 million (USD 45,380). Only 3.1% of surveyed MSMEs have annual turnover above NPR 30 million (USD 272,281) which is the highest range.

In terms of annual expenditure, in line with the annual sales, 82% of surveyed MSMEs have shared that their annual expenditure is below NPR 2.5 million (USD 22,690), while 12.4% have indicated their annual expenditure is between NPR 2.5 million (USD 22,690) and NPR 5 million (USD 45,380). Only 1.1% MSME have indicated that their annual expenditure is above NPR 30 million (USD 272,281). Echoing with their annual turnover and expenditure, almost 93% of surveyed enterprises have indicated their annual profit is below NPR 2.5 million (USD 22,690), while 4.9% have reported their annual profit between NPR 2.5 million (USD 22,690) and NPR 5 million (USD 45,380).

**Culture of Underreporting might have Affected Survey Findings:** Since a significant percentage of MSMEs, especially micro institutions, do not maintain proper books of account and have their financial statements audited, accordingly, a considerable number of MSMEs might have underreported their annual turnover, expenditure and profitability. Therefore, a significant number of MSMEs have selected the lowest range i.e. below NPR 2.5 million for all the three categories during the national survey. Moreover, the culture of keeping financial figures confidential for various purposes might have affected the study finding.

The survey finding of underreporting is further justified by the following cross tabulations. According to a general established banking practice (or rule of thumb), the average value of the annual turnover of any business enterprises is assumed to be at least four times of its working capital credit. The findings of the survey indicate that the average credit size per MSMEs is NPR 3 million (USD 27,228) and 65.29% MSMEs who are availing credit from BFIs have borrowed to manage working capital (refer to 5.1.2.4 Outstanding Credit Portfolio section). Considering the findings of the survey and the established banking practice, the average working capital credit portfolio of MSME is NPR 1.95 million (USD 17,777) (65.29% of NPR 3,000,000) hence the average total annual turnover (sales) of MSMEs will be NPR 7.83 million (USD 71,110) (annual turnover=average working capital *4 times, NPR 1.95 million*4=NPR 7.83 million).

**Central Bank Plans to Discourage the Maintenance of Multiple Books:** It is a common practice amongst enterprises of all size to maintain separate books of accounts, and MSMEs are no exception to this practice. The enterprises present books with lower turnover and profit for tax purposes but provide books with higher turnover and profit to the banks to access higher levels of credit. Understanding the situation, the latest central bank directives requires BFIs to collect tax clearance certificates from businesses while renewing the old and/or extending a new credit. This new requirement is likely to discourage businesses from maintaining separate books of accounts and to maintain proper books with a regular financial audit.

**Average Profitability of MSMEs is between 1 to 20% of Annual Turnover:** As per the supply side findings, the average profitability of MSMEs ranges between 1 to 20% of annual turnover.

**5.1.2.3 Access to Start-up Funding**

MSMEs were asked how they had financed their businesses in the initial phase or during the start-up of their business. Almost half of them (45%) stated that they had used their own funds/savings to start their business. About 31.3% MSMEs were financed through a financial institution. Likewise, 14.4% MSMEs said that they borrowed from their friends and family members, while 6.2% borrowed from money lenders to access initial financing. The surveyed MSMEs had invested NPR 725.1 million (USD 6.5 million) during the initial phase of their business operations.
Average Equity Capital is NPR 2.5 million: The average equity capital of MSMEs surveyed is NPR 2.5 million (USD 22,690). In terms of size, the Micro enterprises have an average equity capital of NPR 2.1 million (USD 19,059) while the Small enterprises have an average equity capital of NPR 2.7 million (USD 23,375).

Commercial Banks, Most Preferred Financial Service Provider: Out of 31.3% of MSMEs who borrowed from financial institutions (BFIs licensed by NRB and Savings Cooperatives), 46% of respondents have borrowed from an “A” class commercial banks while over 25% respondents borrowed from a financial cooperative followed by “B” class Development bank (15%), “D” class Microfinance (9%), and “C” class Finance Company (5%).

5.1.2.4 Outstanding Credit Portfolio
With regards to existing credit portfolios, only 38% of surveyed MSMEs have outstanding credits. The findings also echo with Enterprise Survey 2013 conducted by World Bank, which shows only 35% of the firms in Nepal have bank credit. In term of size, 52.9% of Micro enterprises have outstanding credit, while 37.6% of Small enterprises have outstanding credit followed by others (9.4%).

The Average Credit Size is NPR 3 million: The total outstanding credit of surveyed MSMEs is NPR 511.10 million (USD 4.63 million), while the average credit size per MSME is NPR 3 million (USD 27,228). In terms of the size, the average credit size of Micro enterprises is NPR 1.9 million (USD 17,245) while the credit size of Small enterprises is NPR 4.3 million (USD 39,028). The other enterprises have an average credit size of NPR 3.8 million (USD 34,490).

Average MSME Credit Varies across BFIs: Due to the respective internal definitions for MSME credit by BFIs, the average MSME credit size varies across BFIs. The supply side findings indicate that the average upper limit for MSME credit is NPR 50 million (USD 453,802) while the lower limit is NPR 1 million (USD 9,076). Most BFIs categorize loans above the upper range as mid-corporate credit, while credit provided to individuals within the upper range is also categorized as MSME credit.

Borrowing from a Financial Institution is becoming a Norm: Among the enterprises who have outstanding credit portfolio (38%), almost 79% of them have borrowed from a financial institution. Among the financial institutions, “A” class commercial bank is catering to 60.4% of MSMEs who borrow from BFIs followed by financial cooperatives (27.6%), “D” class microfinance institutions (15%), “B” class development banks (9.7%) and “C” class finance company (0.7%). The findings indicate that MSMEs prefer to borrow from a financial institution once the business is firmly established. With increasing access of financial services across the country, the figures are likely to improve in future.
Dominance of Collateral Backed Lending: Due to the absence of adequate financial infrastructure and lack of credit information in the market, BFIs rely mostly on conventional immovable collateral to extend credit. Out of the outstanding credit, almost 76% of credit is backed by a tangible collateral. Almost half of the credit is backed by both land and building (48%) followed by land (36%) and building (10%). The findings reflect the existing industry figures as per the annual data of FY 2017/18 published by the central bank, of the total outstanding credit of BFIs, 61.7% is backed by collateral of land and building.

Credit Granted to Only 50% of Collateral Value: MSMEs who have provided adequate collateral to a financial institution, on an average are able to receive only about 50.88% of their collateral value as credit. As per the findings, about 40% of surveyed MSMEs were able to receive more than 60% value of collateral as credit. The findings echo with the supply side interviews, where financial institutions on an average provide a maximum of 80% of collateral value based on their internal distress value calculations of collateral.

5.1.2.5 Credit Denial
Since a significant number of the surveyed MSMEs have neither used financial services during inception/start-ups or existing operations, only a marginal number of MSMEs (10.2%) have indicated that they have been declined for credit by a financial institution.
Inadequate Collateral, Key Reason for Credit Denial: As per the MSMEs which were denied credit from financial institutions, 39.5% stated that “inadequate collateral” was the key reason behind denial of credit; 16.3% shared “lack of proper documentation” to be one of the reasons, and 9.3% consider “inferior quality collateral” as another reason for credit rejection. “Lack of trust” is also said to be a key challenge to access credit.

5.1.2.6 Reasons for Taking Credit
Due to the changing requirements of credit financing as per the business cycle of the enterprise, the surveyed MSMEs were asked to provide the key reason for taking credit in three different scenarios:

a. During initial investment;
b. For outstanding credit; and
c. Future credit requirement.

Working Capital Credit, Key Reason for Credit: Across three phases of the business cycle, the need for working capital is clearly the main reason for taking credit. During the initial investment phase, 40.9% of surveyed MSMEs had borrowed for managing working capital, followed by 65.3% MSMEs who are currently availing credit. Similarly, 53.5% of MSMEs who intend to borrow in the near future
need credit for working capital financing. Besides working capital credit, credit for purchasing Machinery and Equipment is the key reason for borrowing.

**Credit for MSMEs Dominated by Demand for Long Term Credit:** In both scenarios, for existing credit portfolio as well as future investments, a significant number of surveyed MSMEs have indicated usage of credit for a long term financing requirement. 72% of MSMEs who are currently borrowing from financial institutions have credit of a long term nature. The average tenure of such credit is 3.8 years. Similarly, the MSMEs who intend to borrow in near future, almost 88%, plan to take credit of a long term nature.

### 5.1.2.7 Reasons for the Lack of Use of Formal Financial Services

In two instances, for initial investment/start-up financing and the outstanding credit, the surveyed MSMEs were asked why they did not use financial services to meet their financing requirements. In terms of initial investment/start-up financing, 21% of MSMEs have indicated high interest rate along with lack of collateral (17.1%) as major reasons for the lack of use of formal financial services to meet their financial requirement. Likewise, in terms of other (30.8%) reasons, the majority said “there is no need for credit” while some indicated “lengthy credit processing time at bank” and “banks did not entertain small value credits” as key factors behind their lack of use of formal financial services.

**Figure 20:** Reasons for Lack of Use of Financial Services during Initial Investment.

- **Others** | 30.8%
- **High interest rate** | 21.1%
- **Did not think that BFIs cater to our need** | 7.1%
- **Did not trust the BFIs** | 2.4%
- **Unavailability of financial institutions** | 1.6%
- **Lack of knowledge about SME financing from BFIs** | 6.2%
- **Lack of collateral** | 17.1%

**Figure 21:** Reasons for Lack of Use of Financial Services for Outstanding Credit.

- **Others** | 12.5%
- **Lack of collateral** | 39.6%
- **No access of banks** | 8.3%
- **High interest rate** | 25.0%
- **Fear of debts** | 14.6%
Lack of Collateral, Key Barrier to Access Formal Financial Services: Currently, only 38% of MSMEs surveyed have outstanding credit, out of which almost 79% have accessed credit from a financial institution. Nonetheless, MSMEs who did not borrow from a financial institution have indicated “lack of collateral” (39.6%) as the key barrier to access credit followed by “high interest rate” (25%) and “fear of debt” (14.6%).

5.1.2.8 Credit Appetite

Over 72% of MSMEs surveyed intend to take out additional credit in near future for their businesses. The total credit demand by surveyed MSMEs is NPR 1,043 billion (USD 9.46 billion), the demand for credit will be highlighted in detail in Section 6.

Micro Enterprises Edges Small Enterprises Over Future Credit Demand: 48.1% of MSMEs have indicated that they intend to make further investments, while around 42% of small enterprises indicated to make future investments. Nonetheless, only 9.6% enterprises from the Others’ category intend to make future investments.

Borrowing from Financial Institutions, Major Source for Further Investments: 64.5% of enterprises who intend to make further investments plan to borrow from financial institutions; 26.2% of enterprises intend to use their business reserves. In terms of preference of financial institutions, almost 60% plan to borrow from “A” class commercial banks, 15.3% from financial cooperatives (15.3%) and 14.4% from “B” class development banks.

Lack of Collateral to Secure Credit: From the surveyed MSMEs who intend to make further investments, almost 33% have indicated that they do not have adequate/additional collateral to secure credit from a financial institution.

One third MSMEs do not Require Future Credit: Almost one third of the surveyed MSMEs have indicated that they do not intend to make further investments. Almost 40% MSMEs have indicated various reasons (Others) behind the absence of future investment plans. The primary reasons are: lack of a successor to look after the business, new business, absence of an investment plan, satisfaction with existing operations, and labor issues.

Figure 22: Reasons for Not Requiring Additional Credit.

<table>
<thead>
<tr>
<th>Reason</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Others</td>
<td>40.2%</td>
</tr>
<tr>
<td>Low growth prospect</td>
<td>23.6%</td>
</tr>
<tr>
<td>High risk</td>
<td>7.1%</td>
</tr>
<tr>
<td>Not required due to capacity</td>
<td>29.1%</td>
</tr>
<tr>
<td>constraint</td>
<td></td>
</tr>
</tbody>
</table>

Apart from the aforementioned reasons, “not required due to capacity constraint” was indicated by 29.1% respondents, and “low growth prospect” was indicated by 23.6% MSMEs as major reasons for not requiring additional credit in the future.
5.2 Supply Side Findings

5.2.1 Current Scenario of Credit towards MSMEs

**Definition of MSMEs Differs across Financial Institutions:** NRB has established a definition for credit provided to MSMEs. However, BFIs have their respective internal definition of MSMEs. Their defining criteria is their credit volume but the amount varies between the BFIs.

Table 8: Definitions given by BFIs to MSMEs on the Basis of Credit Volume.

<table>
<thead>
<tr>
<th>Banks</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank A</td>
<td>Up to NPR 70 million</td>
</tr>
<tr>
<td>Bank B</td>
<td>Up to NPR 60 million</td>
</tr>
<tr>
<td>Bank C</td>
<td>Up to NPR 40 million</td>
</tr>
<tr>
<td>Bank D</td>
<td>Up to NPR 200 million</td>
</tr>
<tr>
<td>Bank E</td>
<td>Up to NPR 50 million</td>
</tr>
<tr>
<td>Bank F</td>
<td>From NPR 500,000 to 30 million</td>
</tr>
<tr>
<td>Bank G</td>
<td>Up to NPR 100 million</td>
</tr>
<tr>
<td>Bank H</td>
<td>Micro credit: Up to NPR 1 million; Small: Above NPR 100,000 to 30 million; Medium: Above NPR 1 and up to 100 million.</td>
</tr>
</tbody>
</table>

**Credit Portfolio of BFIs towards MSMEs Ranges between 20 to 30% and they Pledge to Increase it:**
Most of the BFIs’ current SME portfolio ranges from 20 to 30% and have a separate department to handle the MSME credit portfolio. The remaining BFIs are in the process of opening a separate department to grow their portfolio.

Lack of Specialized Products for MSME Sector: In terms of MSME products, most of the interviewed BFIs do not have a specialized product, however BFIs have customized their credits depending on the needs of their clients.
As far as the third party guarantee credit is concerned, none of the BFIs have any experience of issuing credit on the basis of the third party guarantee.

**Credit towards MSMEs to Meet Regulatory Requirements:** In case of the target markets in MSME credit, almost all of the BFIs cater to the productive sector as prescribed in the definition stated by NRB. They do not provide credit to unregistered businesses following the regulations given by the government. However, personal credit can be given on the basis of individual capacity. One of the BFIs follows the cap set by NRB, agriculture (15%) and tourism (10%) and another BFI has placed tourism in the main segment and agriculture under the Deprived Sector. One of the BFIs shared that they focus on Loans to Youth under the agricultural credit, in which they provide 5% subsidy and refunds 5% of credit to the client, which is later compensated by NRB.

**Various Reasons Restricting Credit towards MSME Sector:** The rate of rejection of MSME credits in the central offices of the BFIs is low as they only receive the applications which are thoroughly checked and approved by the branch offices as per the requirements of the BFI. However, BFIs seem to share the reason behind rejection of credit applications, the most important reason for disapproval of credit is said to be lack of collateral or insufficient collateral. Similarly, other reasons for rejection that the BFIs shared were: lack of financial documentation, proposals from unregistered businesses, poor performance and inability of the applicant to justify the purpose of the loan. Some additional reasons given were lack of experience of the MSMEs in the particular sector and the discrepancy between the financial documentation and the physical assets.

**Lack of Proper Documentation, Key Challenge:** This sector is yet to be fully organized, as a result the applicants fail to submit required supporting documentation such as: tax certificates and financial statements. The borrowers are said to lack financial discipline due to the absence of customer credit history and the presence of informal business transactions (which are not routed through the BFIs). In the case of MSMEs in rural areas they are late in credit processing due to the lack of available accountants and valuers. These aforementioned reasons lead to rejection of credit to MSMEs and also challenges the expansion of MSME portfolios of the BFIs despite their willingness to do so.

**Streamlining Credit Approval Process to Expedite Credit Growth:** The current credit approval process is said to be time consuming. In order to expedite the process it was suggested that a scoring model...
could be created for a set amount of credit for MSMEs. A guideline specifying the procedures for MSME credits would also be helpful so that the decisions do not have to wait for the higher authority’s approval for a small amount of credit.

**Regulatory Changes Required to Expedite Credit towards MSME Sector:** It was also suggested that NRB could be lenient with the criteria for credits to MSMEs as this is a beginner’s credit and it is difficult for them to comply with all the criteria. One of the BFIs believes that the dependence upon collateral-based funding is also a challenge which can be addressed with NRB’s declaration upon the obligation to furnish tax clearance certificates by the borrowers.

### 5.2.1.1 Centralized Lending System

Central Offices of the BFIs are the final decision makers in terms of approval of credit. This is seen to be a common procedure for all the BFIs which were interviewed for this study as they shared that they followed a centralized credit approval system. Although the applications are received at the branch offices and screened for shortlisting, it is the center that decides on the final credit approval. However, some of the BFIs do envisage decentralization of authority for credit approval.

**Illustration of Good Practice:** The Head Office of a bank has provided a lending mechanism that is to be followed by the respective branch offices whilst providing credit. At the regional level, the Regional Manager has the capability to provide credit up to NPR 50 million (USD 453,802) and the Branch Managers have the ultimate authority to provide an SME credit up to NPR 10 million.

### 5.2.1.2 Requirement of Collateral

Credit for MSMEs cannot be approved without collateral and this is a common requirement in all the BFIs. The BFIs have different lists under collateral for MSME credit. For some, it can be fixed assets, such as land and buildings, for others, primary collateral would include stock, plant and machinery and secondary collateral would comprise of land and buildings. The latter are said to be the most common forms of collateral in the case of MSME credits.

Some of the BFIs shared their leniency/flexibility in terms of collateral, they said that if the credit seeker has proven track record and has a credit guarantee, they would even consider stocks as collateral. In case of a new credit, the BFIs require 100% collateral but if the client has proven track record in business, they would consider to issue the credit with 70% collateral from land and buildings and 30% from stock.

### 5.2.2 Perception on CGS

Most of the BFIs stated that a CGS could be a useful initiative. CGS contributes in minimizing the risks of BFIs and helps them develop new products based on the needs of the MSMEs. However, they stressed that the CGS model for Nepal will have to consider a few things to make it effective:

- It should have clear and easy modality.
- Its success would depend on the cost it charges to the bank as bank will ultimately pass the cost to its borrower.
- The CGS model has to ensure that fund is not misused. In order to create credibility and sustainability, it would be better if it comes through NRB with provisions and liberal clauses for Non-Performing Assets in this scheme.
- CGS model has to be aligned with bank’s interests, profitability and growth to be successful.

### 5.2.2.1 Potential Interventions of CGS

Majority of the BFIs believe that CGS can help in addressing the gaps in financing MSMEs if they are created after understanding MSMEs’ needs as well as the limitations of extending credit to them.
Some BFIs expect additional services from the CGS model apart from the granting guarantees for credit, e.g. the provision of technical financial knowledge/guidance to the MSME borrowers on the usage and feasibility of the guarantee and on how the guarantee process works.
6. Conclusion

6.1 Total Formal Credit Demand in MSME Sector

As per the findings from the survey, the total formal credit demand of the MSME sector has been computed to be NPR 1,043 billion (USD 9.5 billion)\(^{11}\); the average formal credit demand per MSME is NPR 5 million (USD 45,391). Since only 72% of surveyed MSMEs have indicated that they require finance from a financial institution (meaning that 28% MSMEs do not require credit for their business) thus, the total credit demand has been extrapolated based on the credit demand indicated by 72% of MSMEs only. The findings closely reflect the World Bank estimate as well. As per World Bank Enterprise Survey (2013), the percentage of firms not needing a credit in “all countries” is 46.4%, “South Asia” is 44.7% and “Nepal” is 36.1%. In the upcoming sections, the total formal credit demand has been further segregated according to size of the enterprise, province, sector and geographical region.

6.1.1 Breakdown of Formal Credit Demand by Size of Enterprise

The demand for credit is highest in small enterprise segment. The total credit requirement of a small enterprise (46%) is estimated to be NPR 478 billion (USD 4.3 billion). Like small enterprise, micro enterprise also mostly operate in agriculture, service and manufacturing and have a significant demand for the working capital. In fact, the findings suggest that 40% of the credit demand amounting to NPR 418 billion (USD 3.7 billion) is from micro enterprises.

Figure 25: Demand for Formal Credit According to Size of Enterprise (in NPR billions)

Unlike small and micro enterprises, the others (14%) which include a mixture of medium, large and cottage scale industries have exhibited a lower demand for credit. Nevertheless, as the category “others” does not represent the primary scope of our study it can be considered as an outliers. Most of the businesses in these segments are typically structured as a sole proprietorship.

\(^{11}\)Since significant number of MSMEs are also registered with CRO and local municipalities, the total number of MSMEs operating in Nepal and the demand for the formal credit would be much higher. For instance the IFC has estimated 1.3 million MSMEs operating in Nepal.
6.1.2 Breakdown of Formal Credit Demand by Province

The findings of the survey conclude that the demand for formal credit is highest in province 5 (34%) with NPR 356 billion (USD 3.2 billion) followed by province no. 1 (24%) with total credit demand of NPR 250.40 (USD 2.2 billion).

Figure 26: Demand for Formal Credit According to Province (In NPR billions)

Similarly, province 3 (20%) has a total credit demand of NPR 210.5 billion (USD 1.9 billion). As expected, the demand is lowest in province 6 and 7 with 1% and 2% respectively of the total formal credit demand.

6.1.3 Breakdown of Formal Credit Demand by Sector

The demand for formal credit is highest in the service sector (48%) with approximately NPR 495.8 billion (USD 4.4 billion) of the total demand followed by the manufacturing (18%) with total credit demand of NPR 189.8 billion (USD 1.72 billion). Likewise, the demand for the agriculture sector (17%) is NPR 183 billion (USD 1.6 billion while that of tourism sector (14%) is NPR 148.3 billion (USD 1.3 billion) of the total formal credit demand.

Table 9: Demand for Formal Credit According to Sector (amount in billion NPR billion)

<table>
<thead>
<tr>
<th>Province</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>Total</th>
<th>In %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>76.00</td>
<td>24.86</td>
<td>25.74</td>
<td>3.74</td>
<td>46.69</td>
<td>1.29</td>
<td>4.70</td>
<td>183.01</td>
<td>17</td>
</tr>
<tr>
<td>Service</td>
<td>155.02</td>
<td>52.81</td>
<td>122.17</td>
<td>20.93</td>
<td>132.77</td>
<td>1.30</td>
<td>10.84</td>
<td>495.84</td>
<td>48</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>2.45</td>
<td>45.08</td>
<td>21.77</td>
<td>5.80</td>
<td>105.40</td>
<td>2.64</td>
<td>6.76</td>
<td>189.89</td>
<td>18</td>
</tr>
<tr>
<td>Tourism</td>
<td>15.78</td>
<td>34.78</td>
<td>26.92</td>
<td>0.64</td>
<td>70.20</td>
<td>0.00</td>
<td>0.00</td>
<td>148.32</td>
<td>14</td>
</tr>
<tr>
<td>Others</td>
<td>1.16</td>
<td>6.44</td>
<td>13.91</td>
<td>2.13</td>
<td>0.64</td>
<td>0.64</td>
<td>1.29</td>
<td>26.21</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>250.40</td>
<td>163.97</td>
<td>210.51</td>
<td>33.23</td>
<td>355.70</td>
<td>5.87</td>
<td>23.59</td>
<td>1043.28</td>
<td></td>
</tr>
</tbody>
</table>
Further findings of the survey also support the fundamentals of Nepali economic structure. As per the data published by NRB\textsuperscript{12}, the service sector is booming in Nepal with 53\% (NPR 1.5 trillion; USD 13.6 billion) of the GDP contribution followed by agriculture (32\%) and manufacturing (15\%). Figure below provides the contribution in detail.

6.1.4 Breakdown of Formal Credit Demand by Geographical Specificities

Out of the total demand for formal credit, the highest demand for credit is from the Terai region amounting to NPR 563.6 billion (USD 5.1 billion) which is 54\% of the total credit demand. Likewise, the hilly region (43\%) has a total credit demand of NPR 453 billion (USD 4.1 billion) followed by mountain region (3\%) with a minimal demand of NPR 26 billion (USD 235 million).

Table 10: Demand for Credit According to Geographical Specificities

<table>
<thead>
<tr>
<th>Region</th>
<th>Demand (in NPR)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Terai</td>
<td>563.59</td>
<td>54%</td>
</tr>
<tr>
<td>Hills</td>
<td>453.09</td>
<td>43%</td>
</tr>
<tr>
<td>Mountain</td>
<td>26.60</td>
<td>3%</td>
</tr>
</tbody>
</table>

6.2 Total Formal Credit Supply for MSME Sector

The total supply of formal credit has been calculated by considering the total credit allocated by the financial sector to MSME sector. In this regard a two pronged approach has been considered;

1) Approach 1: Total credit portfolio of Banks and Financial Institutions (BFIs) that includes “A” class commercial banks, “B” class development banks and “C” class finance companies; and
2) Approach 2: Total credit portfolio of “A” class commercial banks only.

Despite the established definition of credit to the SME sector outlined by the central bank (NRB), the definition of “credit to the MSME sector” is unique in each financial institution. Moreover, BFIs are not required to publish their credit portfolio towards the MSME sector separately, therefore the actual credit towards the MSME sector by BFI is not available. Nonetheless, our supply side interviews with key stakeholders suggest that “on an average BFI credit towards the MSMEs sector is between 20 to 30\% of their total credit portfolio”.

Based on the first approach, considering the latest statistical report of Nepal Rastra Bank\textsuperscript{13}, the total credit portfolio of BFIs is NPR 2.4 trillion (USD 21.7 billion) therefore, considering that the total credit towards the MSMEs is 25\%\textsuperscript{14}, the total supply of credit towards the MSME sector is NPR 605 billion (USD 5.4 billion).

\textsuperscript{12} Annual Macroeconomic Outlook, Fiscal year 2017/18, NRB
\textsuperscript{13} Monthly Statistical Report, July 2018, Nepal Rastra Bank
\textsuperscript{14} We have considered mean value of 25\% as a benchmark to calculate supply of funds
Likewise, based on the second approach, the total credit portfolio of commercial banks is NPR 2.1 trillion (USD 19 billion). Given the information, the total supply of credit towards the MSME sector is NPR 527 billion (USD 4.7 billion).

The Making Access Possible (MAP) Demand Study 2015, findings also echo that only 34% of MSMEs are served by formal financial institutions; of which 15% MSMEs get access to credit from banks (licensed by NRB) while 14% MSMEs are served by other formal institutions such as financial cooperatives. Likewise, 16% MSMEs are served by informal while 5% are served by Friends and Families/at home. Nonetheless, 50% of MSMEs are totally excluded in terms of access to finance.

Table 11: Supply of Formal Credit towards the MSME Sector

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Date</th>
<th>Total credit portfolio of Commercial Banks</th>
<th>Total credit supply of Commercial Banks considering (25% of credit)</th>
<th>Total credit supply of BFIs considering (25% of credit)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supply of fund (in NPR billions)</td>
<td>Mid-July 2018</td>
<td>2,109.00</td>
<td>2,419.00</td>
<td>527</td>
</tr>
</tbody>
</table>

Source: Banking Statistics, July 2018, Nepal Rastra Bank

6.3 Total Formal Credit Gap in MSME Sector

As shown in the figure below, the total formal credit gap considering the first approach—the total formal credit gap is NPR 438 billion (USD 3.9 billion) in contrary, considering the second approach, the total formal credit gap is NPR 516 billion (USD 4.6 billion).

Figure 27: Total Credit Gap Considering Total Credit Supply of BFIs (first approach)
The national GDP grew by 6.3% to NPR 3 trillion (USD 27.2 billion) in the FY 2017/18. If we consider the first approach, the total credit gap to GDP ratio stands at 14.3%. Likewise the ratio is 17% considering the second approach. The total formal credit gap to the MSME sector also reflects international standards, and findings from the IFC similarly suggest that the credit gap in formal MSMEs sector in developing countries is equivalent to 19% of GDP.\textsuperscript{15}

6.4 Way Forward

The overall assessment of the demand and supply side study indicates the presence of a significant gap on supply of formal credit to the MSME sector in Nepal. The total formal credit gap is almost 15% compared to the national GDP. According to the findings of this study, a huge number of MSMEs used their own funds or borrow from informal providers such as, families and friends, to finance their business as they lack collateral and proper supporting documentation. The informal borrowings come with higher interest rates for a short span of time, thereby limiting their business activities. This implies a missed opportunity for MSMEs and potentially inefficient financial intermediation which indicates a major gap between demand and supply of financial services for MSMEs. Additionally, fluctuating interest rates in the banking system and high risks associated with MSME credit due to their low levels of disclosure have impacted the opportunity for commercial borrowing from the formal credit providers.

Despite various efforts from the private sector, government and development partners, numerous challenges persist at ground level. The situation needs immediate attention to enable the growth of MSME sector. The following arguments support the idea that the growth of MSME sector is key for national economic growth.

\textsuperscript{15} “MSME finance Gap-Assessment of the shortfall and opportunities in financing micro, small, and medium enterprise in emerging markets”: International Finance Corporation, Washington DC (2017): 1-80
• **MSME Sector, a Key Engine for Economic Growth and Employment Generation:** Nepal’s private sector, a major contributor to GDP is dominated by small enterprises. The International Finance Corporation estimates that they employ 1.75 million people and account for 22% of the country’s GDP. As Nepal embarks on the path of economic development and prosperity under the new federal structure, the role of MSME sector to create jobs and further economic development has amplified. The role of MSME is even more crucial in the current economic situation as there is a need to produce domestic goods and services to mitigate high imports that resulted in the trade deficit which has surpassed NPR 1.1 trillion (USD 9.98 billion). Similarly, the growth of the MSME sector is crucial in supporting the government’s objective of achieving higher economic growth and reducing poverty by generating employment, and in line with its vision to graduate from a Least Developed Country status by the 2022.

• **Government has Clear Mandate for MSME Growth:** To capitalize on the available local materials, resources and skills, the newly formed federal government has decided to open industrial village/parks in each of the 753 local bodies. This reflects the clear intention of government to promote and support MSMEs nationwide. As real estate prices have increased local MSMEs do not have the capacity to retain or expand infrastructure. In this context, the government’s proposed industrial parks would benefit local MSMEs by providing them the infrastructural support. Furthermore, the budget of FY 2018/19 has announced the establishment of a “challenge fund” to provide startup capital for businesses initiated by entrepreneurs with innovative knowledge, skill and capacity.

• **The Potential of “Transformative Enterprises”**: With the growth of domestic disposal income, rapid urbanization and changes in taste and technological innovation, domestic demand for quality products and services is on the rise. With the rise in demand, the entrepreneurial aspiration has increased and provided ample opportunities for existing MSMEs to graduate to the next level. The equation is bound to create space for development of “transformative enterprises” which can play the role of a catalyst and positively influence structural transformation of the economy.

The MSME sector has a huge potential for growth. However, besides the traditional banking channels, there are limited services that cater to their needs:

• **Private Equity**: The regulation for this sector is still under review. Only a few private equity firms are currently operating in Nepal, catering largely to the medium scale enterprises with a proven track record.

• **Deposit and Credit Guarantee Fund**: The government body currently focuses more on the provision of a deposit guarantee.

• **Various Government Programs**: Few government programs are in place to support youth employment and promote entrepreneurship. Nonetheless, the scope is limited to generate self-employment with minimal interest subsidy.

• **Credit driven by Central Bank Directives**: Both productive sector lending and deprived sector lending requirements have helped to push credit towards the selected sectors. Nonetheless, it has its own limitations. For BFIs, productive sector lending has to be backed by collateral while deprived sector lending mostly caters to group based microfinance borrowers.

• **Capital Market**: The market is in a nascent stage and lacks both depth and breath, dominated by financial institutions largely due to mandatory regulatory requirement.

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16 Retrieved from http://www.ifc.org/wps/wcm/connect/REGION__EXT_Content/IFC_External_Corporate_Site/South+Asia/Countries/Nepal/

17 Budget 2018/19
• **Development Partners Aided Programs:** There are limited development partner aided programs and projects to support the MSME sector. Apart from a few programs which provide interest subsidies most of these programs are focused on enhancing financial inclusion and skills development.

The Demand Study on MSME Financing shows a significant credit gap for MSMEs and the need for policy makers, regulators, donor agencies, market actors and other stakeholders to agree on a mechanism and an institutional model to catalyze commercial lending, and contribute to change in Nepal’s banking sector by jumpstarting innovative and sustainable MSME lending in Nepal.
7. Bibliography


Levitsky. J.,(1997); Credit guarantee schemes for SMEs an international review, Small Enterprise Development, No 2 June 1997.


8. Appendix

**Appendix 1: IFC**

<table>
<thead>
<tr>
<th>Indicator/Size of the enterprise</th>
<th>Micro Enterprise</th>
<th>Small Enterprise</th>
<th>Medium size enterprise</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Employees</td>
<td>&lt;10</td>
<td>10&lt;50</td>
<td>50-300</td>
</tr>
<tr>
<td>Total Assets</td>
<td>&lt;$100,000</td>
<td>$100,000&lt;$3 million</td>
<td>$3 million &lt; $15 million</td>
</tr>
<tr>
<td>Annual Sales</td>
<td>&lt; $100,000</td>
<td>$100,000&lt;$3 million</td>
<td>$3 million &lt; $15 million</td>
</tr>
</tbody>
</table>

*Source: Khodakaviska Alla*

**Appendix 2: European Union**

<table>
<thead>
<tr>
<th>Company Category</th>
<th>Staff Headcount</th>
<th>Turnover or Balance Total</th>
<th>Sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medium-sized</td>
<td>&lt; 250</td>
<td>≤ € 50 m</td>
<td>≤ € 43 m</td>
</tr>
<tr>
<td>Small</td>
<td>&lt; 50</td>
<td>≤ € 10 m</td>
<td>≤ € 10 m</td>
</tr>
<tr>
<td>Micro</td>
<td>&lt; 10</td>
<td>≤ € 2 m</td>
<td>≤ € 2 m</td>
</tr>
</tbody>
</table>

*Source: What is an SME?*

**Appendix 3: MSMED Act and Recent Proposal for Defining MSMEs, India**

**Under MSMED Act 2006**

**Manufacturing Sector**

<table>
<thead>
<tr>
<th>Enterprises</th>
<th>Investment in Plant &amp; Machinery</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro Enterprises</td>
<td>Does not exceed twenty five lakh rupees</td>
</tr>
<tr>
<td>Small Enterprises</td>
<td>More than twenty five lakh rupees but does not exceed five crore rupees</td>
</tr>
<tr>
<td>Medium Enterprises</td>
<td>More than five crore rupees but does not exceed ten crore rupees</td>
</tr>
</tbody>
</table>

**Service Sector**

<table>
<thead>
<tr>
<th>Enterprises</th>
<th>Investment in Equipment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro Enterprises</td>
<td>Does not exceed ten lakh rupees:</td>
</tr>
<tr>
<td>Small Enterprises</td>
<td>More than ten lakh rupees but does not exceed two crore rupees</td>
</tr>
<tr>
<td>Medium Enterprises</td>
<td>More than two crore rupees but does not exceed five core rupees</td>
</tr>
</tbody>
</table>

*Source: Ministry of Micro, Small and Medium Enterprises.*

**Recent proposal: Define MSMEs on the basis of annual sales turnover.**

1) **Micro:** Not more than Rs. 50 million.
2) **Small:** More than Rs. 50 million but does not exceed Rs. 75 crore.
3) **Medium:** More than Rs. 75 crore but does not exceed Rs. 250 crore.

*Source: Press Information Bureau, 2018.*
Appendix 4: Central Bank, Bangladesh
For Small Businesses:

<table>
<thead>
<tr>
<th>S.N.</th>
<th>Sector</th>
<th>Fixed Asset Other than land and building</th>
<th>Employed manpower (not above)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Service</td>
<td>50,000-50,00,000</td>
<td>25</td>
</tr>
<tr>
<td>2</td>
<td>Business</td>
<td>50,000-50,00,000</td>
<td>25</td>
</tr>
<tr>
<td>3</td>
<td>Industrial</td>
<td>50,000-1,50,00,000</td>
<td>50</td>
</tr>
</tbody>
</table>

For Medium Enterprises:

<table>
<thead>
<tr>
<th>S.N.</th>
<th>Sector</th>
<th>Fixed Asset Other than Land and Building</th>
<th>Employed Manpower (not above)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Service</td>
<td>50,00,000-10,00,00,000</td>
<td>50</td>
</tr>
<tr>
<td>2</td>
<td>Business</td>
<td>50,00,000-10,00,00,000</td>
<td>50</td>
</tr>
<tr>
<td>3</td>
<td>Industrial</td>
<td>1,50,00,000-20,00,00,000</td>
<td>150</td>
</tr>
</tbody>
</table>

Link: https://bb.org.bd/openpdf.php

Appendix 5: Classification of Industry as per Industrial Enterprise Act and Definition of SME as per Unified Directives of NRB

Classification of Industry, Industrial Enterprise Act, Nepal

1. Micro Industry
   - Maximum of nine employees including the investor
   - Annual financial transaction of maximum amount of NPR 5 million
   - Maximum application of 20 KV energy
   - Maximum fixed asset of NRs. 500,000

2. Cottage Industry
   - Based on traditional skill and technology
   - Maximum application of 10 KV energy
   - As stated in the Annex 2 of the Act

3. Small Industry
   - Apart from micro and cottage industry, maximum fixed asset of NPR 100 million

4. Medium Industry
   - Fixed asset between NPR 100 to 250 million

5. Large Industry
   - Fixed asset of more than NPR 250 million

Source: Industrial Enterprise Act 2016

1. Energy Based Industry
   - Industry generating energy from water resources, wind, solar, coal, natural oil and fuel or gas, biomass and similar types of energy producing industry; energy transmission; energy distribution

2. Manufacturing industry
   - Industry based on utilizing or processing of raw materials, auxiliary raw materials, semi-processed materials
<table>
<thead>
<tr>
<th>3</th>
<th>Agro and Forest based industry</th>
<th>Industry based on agriculture or forest products such as integrated sericulture and silk production, horticulture and fruit processing, animal husbandry including bird, dairy industry, poultry farming, fishery, tea/coffee gardening and processing, herbal processing, vegetable seed farming, vegetable farming or processing, tissue culture, green house, bee-keeping, honey production, rubber farming, floriculture and production, cold storage and agro market, lease hold forests, agro forestry, etc.</th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td>Minerals based industry</td>
<td>Industry based on minerals excavation or processing thereof, except that of metal</td>
</tr>
<tr>
<td>5</td>
<td>Construction based industry</td>
<td>Road, bridge, tunnel; ropeway, railway, tram, trolley-bus, cable car, monorail and sliding-car; airway and airport; conference center; waste management; water supply and distribution; irrigation; sport complex and stadium; parking place and parking house; export processing zone; cargo complex; sewage treatment plant; special economic zone; telephone tower, optical fiber network, satellite and satellite transmission center; house and housing complex; film city, film studio; business complex</td>
</tr>
<tr>
<td>6</td>
<td>Tourism based industry</td>
<td>Tourist house, motel, hotel, resort and restaurant; travel agency, tour operator, healing center, casino, massage and spa; adventure tourism; golf course, polo, pony trekking, hiking; village tourism, homestay and ecological tourism; cultural, religious, conference and sports tourism; entertainment part; conservation; mountain flight</td>
</tr>
<tr>
<td>7</td>
<td>Information, transmission and communication based industry</td>
<td>Information technology based industry like technology park, IT park, biotech park, software development, computer and related services, data processing, cyber café, digital mapping, BPO, data mining, cloud computing. Communication based industry like internet, telecommunication, teleport services, satellite establishment and operation, satellite transmission center, VSAT, broad band, optical network, satellite network Transmission based industry like FM radio, digital radio service, digital television, satellite television, cable television, IPTV and online services, Digital cable TV, network, Direct-to-home satellite services, MMDS Network, recording studio, printing media, entertainment services, etc.</td>
</tr>
<tr>
<td>8</td>
<td>Service based industry</td>
<td>Workshop, printing press, consultancy services, ginning and bailing business, cinematography, construction business, public transportation business, photography, hospital, nursing home, educational and training institution, library and museum services, laboratory, air services, sports services, non-agro cold storage, house wiring and electrical fitting and maintenance, waste management services, cargo and courier services, advertising services, packaging and refilling services, foreign employment services, etc.</td>
</tr>
</tbody>
</table>

**Unified Directives of NRB - Definition of SME**

The enterprise fulfilling all given condition are defined as Small and Medium Enterprises:

1. Paid-up capital up to NPR 5 million
2. Fixed assets up to NPR 50 million
3. Involved in production and service sector
4. Entrepreneur involved in business activity

Appendix 6: Sector Sampling Calculation

Table a. Sectoral Segregation of Sample based on GDP contribution to the respective sectors

<table>
<thead>
<tr>
<th>Sector</th>
<th>Weight (Sectoral Contribution to GDP as of 2016/17)</th>
<th>No. of Sample as per GDP Presence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>6%</td>
<td>24</td>
</tr>
<tr>
<td>Agriculture</td>
<td>29%</td>
<td>116</td>
</tr>
<tr>
<td>Service</td>
<td>56%</td>
<td>224</td>
</tr>
<tr>
<td>Tourism</td>
<td>2%</td>
<td>8</td>
</tr>
<tr>
<td>Others</td>
<td>7%</td>
<td>28</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>400</td>
</tr>
</tbody>
</table>

*Source: Ministry of Finance

Limitations:
- Our GDP Contribution is primarily categorized as; Primary (agricultural), Secondary (Manufacturing), tertiary (Service) service. However, the contribution of key sub sectors under these large sectors is not available.

Table b: Sectoral Segregation of Sample based on registration with DOSCI of the respective sectors

<table>
<thead>
<tr>
<th>Sector</th>
<th>Weight (On the basis of Registration with DOSCI as of FY 2016/17)*</th>
<th>No. of Sample as per registration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>36%</td>
<td>144</td>
</tr>
<tr>
<td>Agriculture</td>
<td>12%</td>
<td>48</td>
</tr>
<tr>
<td>Service</td>
<td>38%</td>
<td>152</td>
</tr>
<tr>
<td>Tourism</td>
<td>10%</td>
<td>40</td>
</tr>
<tr>
<td>Others</td>
<td>4%</td>
<td>16</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>400</td>
</tr>
</tbody>
</table>

*Source: DOCSI

Limitations:
- The actuals Operating MSMEs might be different as many of these registered enterprises could be non-operational or dysfunctional. Likewise, weighing sectors only on the basis of registration with DOCSI could not give correct sample size. We haven’t consider industries registered with DOI as almost 99% of the small industries registered with DOI have some degree of foreign investment.
Appendix 7: Provincial Sample Calculation

For the provincial segregation of samples, we have used average of contribution to GDP and registration of industries under each province.

Table a: Provincial Segregation of Sample based on GDP contribution

<table>
<thead>
<tr>
<th>Province</th>
<th>Percentage of GDP Contribution*</th>
<th>Sample (GDP Contribution)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>17%</td>
<td>70</td>
</tr>
<tr>
<td>2</td>
<td>16%</td>
<td>65</td>
</tr>
<tr>
<td>3</td>
<td>32%</td>
<td>128</td>
</tr>
<tr>
<td>4</td>
<td>10%</td>
<td>38</td>
</tr>
<tr>
<td>5</td>
<td>15%</td>
<td>61</td>
</tr>
<tr>
<td>6</td>
<td>3%</td>
<td>13</td>
</tr>
<tr>
<td>7</td>
<td>6%</td>
<td>25</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>400</strong></td>
</tr>
</tbody>
</table>

*Source: Nepal in Data

Table b: Provincial Segregation of Sample based on registration with DOSCI of the respective sectors

<table>
<thead>
<tr>
<th>Province</th>
<th>Percentage of Registered MSMEs*</th>
<th>Sample (no. of registration)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>14%</td>
<td>57</td>
</tr>
<tr>
<td>2</td>
<td>14%</td>
<td>54</td>
</tr>
<tr>
<td>3</td>
<td>37%</td>
<td>147</td>
</tr>
<tr>
<td>4</td>
<td>9%</td>
<td>37</td>
</tr>
<tr>
<td>5</td>
<td>17%</td>
<td>67</td>
</tr>
<tr>
<td>6</td>
<td>4%</td>
<td>14</td>
</tr>
<tr>
<td>7</td>
<td>6%</td>
<td>24</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>400</strong></td>
</tr>
</tbody>
</table>

*Source: Department of Cottage and Small Industry
Appendix 8: Field Survey Questionnaire for MSME Study

Background

Sector/Sub-sector/Category

6. Sub-Sector: Specify: ……
Specify: Other Subsector: ……

If Other Sector, Which sector?
Specify which sub-sector of other sector: ……

Specify Other category: a. Cottage b. Medium c. Large

Location of the enterprise
8. Province a. 1  b. 2  c. 3  d. 4  e. 5  f. 6  g. 7


Enterprise background
If others, please specify: ……

15. Year of business establishment: ……

16. Number of Employees in the organization: ……

17. Your firm is registered with: a. Department of Industries (DOI) b. Company Registrar Office (CRO) c. Department of Cottage of Small Industries (DOCSI) d. Permanent Account Number (PAN) e. Municipality f. Not registered g. Other h. VAT
If others, please specify: ……

If others, please specify: ……
19. Do you export your products? a. Yes b. No

**B. Financial Information**

20. What is the current paid-up capital of the company? (as per registration)

........................

21. Is financial statement/books of accounts prepared and maintained?
   a. Yes b. No

21. Is financial statement audit?
   a. Yes b. No

22. What is your annual turnover/sales?
   a. In NPR Up to NPR 2,500,000 b. Above NPR 2,500,000 up to NPR 5,000,0000 c. Above NPR 5,000,000 up to NPR 10,000,000 d. Above NPR 10,000,000 up to NPR 20,000,000 e. Above NPR 20,000,000 up to NPR 30,000,000 f. Above NPR 30,000,000

23. What is your annual Expenditure?
   a. Up to NPR 2,500,000 b. Above NPR 2,500,000 up to NPR 5,000,000 c. Above NPR 5,000,000 up to NPR 10,000,000 d. Above NPR 10,000,000 up to NPR 20,000,000 e. Above NPR 20,000,0001 up to NPR 30,000,000 f. Above NPR 30,000,000

24. What is yearly average annual Profit?
   a. Up to NPR 2,500,000 b. Above NPR 2,500,000 up to NPR 5,000,0000 c. Above NPR 5,000,000 up to NPR 10,000,000 d. Above NPR 10,000,000 up to NPR 20,000,000 e. Above NPR 20,000,001 up to NPR 30,000,000 f. Above NPR 30,000,000

25. What is the total Investment in fixed assets?

..............

26. What was the Initial Investment when you started the business?

................

27. What was the source of Investment at the beginning?


**Specify Others**

From Which Financial Institution borrowed?

If others, please specify:............

29. If borrowed from Non-Financial Institution what is the Tenure of Loan?
A. Days (Specify) b. Month (Specify) c. Annual (Specify)
Days (Specify Tenure)........Month (Specify Tenure)........Annual (Specify Tenure)........

30. What is the interest rate?

.............

31. If not borrowed from BFIs, why you did not borrow from BFI?
a. Lack of collateral b. Lack of knowledge about SME financing from BFIs? c. Unavailability of financial institutions d. Did not trust the BFIs e. Did not think that BFIs cater to our need f. High interest rate g. Others

Specify Others
32. What is the mode of payment to your supplier?
a. Cash on delivery b. Credit c. Advance d. a and b e. a and c f. b and c g. All

33. What is the mode of your sales?
a. Cash Sales b. Credit Sales c. Both cash and Credit

C. Funding needs
34. Have you currently taken any loan for your business?
a. Yes b. No
35. If yes, from where have you taken out loan from?

Borrow from Financial Institution
If others, please specify:

36. If borrowed from a financial institution, what is the nature of your loan?
a. Short term nature (up to one year) b. Long term nature (more than one year)

37. For Long term nature tenure of loan.
a. 2 years b. 3 years c. 4 years d. 5 years e. More than 5 years

Specify more than 5 years
38. What is the annual interest rate? (For Financial institution borrowers).....

39. What was the use of the Loan you are currently availing?
a. To buy Machinery and equipment b. To buy Furniture and Fixture c. To buy Vehicles d. To finance Working Capital e. Others
If others, please specify

38. What is the current outstanding loan?.........
39. Is your loan backed by a collateral?
   a. Yes  b. No

40. If Yes, What is your collateral?
   a. Land  b. Building c. Both Land and Building  d. Shares  e. Inventory  f. Vehicles  g. Others
   If others, please specify

41. What percentage of loan value was provided on your collateral?...........

42. What is the current market value of your collateral?...........

43. Have you ever been declined credit by any financial institution?
   a. Yes   b. No

44. If yes, what was the reason? If more than one reason rank these:
   a. Inadequate collateral  b. Inferior quality collateral  c. Lack of proper documentation  d. Poor credit history  e. Multiple borrowing  e. Other
   Other Specify
   Why was collateral inferior.......  
   Rank Inadequate collateral.........
   Rank Inferior quality collateral....... 
   Rank Lack of proper documentation........
   Rank Poor credit history.......... 
   Rank Multiple borrowing.......... 
   Rank........

45. If not borrowed from a financial institution, what were the reasons (you can tick on one or more) you did not borrow from a financial institution?
   a. Fear of debts  b. High interest rate  c. No access of banks  d. Lack of collateral  e. Others
   Others Specify

Future Needs

46. Are you planning to make further investment in your business?
   a. Yes   b. No

47. If yes, from where you are planning to meet your investment requirement?
   Borrowing from Financial Institution
   If others, please specify

48. What amount is required for your future investment plans?..........
49. Nature of loan you are planning to up take?
a. Short term nature (less than one year)  b. Long term nature (more than one year)

50. What type of Loan are you planning to take and tenure?
   Others Specify

51. If No further investment is required, what are the reasons?
a. Not required due to capacity constraint  b. Low growth prospect c. High risk d. Others
   Specify Others

52. Do you have the required/additional collateral to access credit from your banking partner?
a. Yes b. No

Take GPS of Interview location
instanceName
instanceID
instanceHistory
Appendix 9: List of Consultation for Provider Segment Survey

<table>
<thead>
<tr>
<th>S. N.</th>
<th>Interviewee</th>
<th>Position</th>
<th>Bank</th>
<th>Location</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Pawan Kumar Acharya</td>
<td>Chief Project Financing Officer</td>
<td>Sanima Bank</td>
<td>Naxal</td>
</tr>
<tr>
<td></td>
<td>Roshan Wagle</td>
<td>Relationship Manager, Microfinance Department</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Yagya P. Sharma</td>
<td>Head Mid Corporate, SME &amp; MF</td>
<td>Nabil Bank</td>
<td>Tripureshwor</td>
</tr>
<tr>
<td></td>
<td>Madhu J. Karki</td>
<td>Assistant Relationship Manager, Mid Corporate, SME &amp; MF</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Manoj Kumar Yadav</td>
<td>Manager-Microfinance. Mid-Corporate, SME &amp; Microfinance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Siris Regmi</td>
<td>Manager- SME</td>
<td>NIC Asia Bank</td>
<td>Trade Tower, Thapathali</td>
</tr>
<tr>
<td>4</td>
<td>Srijana Pandey Rana</td>
<td>Head Corporate Banking</td>
<td>Nepal Investment Bank</td>
<td>Lazimpat</td>
</tr>
<tr>
<td></td>
<td>Aman Shrestha</td>
<td>Deputy Manager Corporate Bank</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Jayendra B. Shah</td>
<td>Executive Officer, Head-Retail &amp; SME Business Development</td>
<td>Himalayan Bank Ltd</td>
<td>Kamaladi</td>
</tr>
<tr>
<td>6</td>
<td>Upendra Malakar</td>
<td>Head Business Banking</td>
<td>Machhapuchchhre Bank Limited</td>
<td>MBL Tower, Lazimpat</td>
</tr>
<tr>
<td>7</td>
<td>Arjun Bhadra Khanal</td>
<td>SME &amp; Consumer Banking</td>
<td>Siddhartha Bank</td>
<td>Anamnagar</td>
</tr>
<tr>
<td>8</td>
<td>Janak Bhattarai</td>
<td>Head, SME</td>
<td>Mega Bank</td>
<td>Kamladi</td>
</tr>
</tbody>
</table>

Appendix 10: Personal Interview Questionnaire for Provider (Bank) Survey

- How do you categorize/define SME loan?
- Do you have a separate department that looks after SME loans, or do you have any special arrangement?
- What is the size of SME portfolio (aggregate number of MSME loan portfolio and total number of MSME loans disbursed)?
- Forecasted SME lending portfolio?
- Types of SME products, Special SME products?
- Can you Share (if any) of guarantee covered part of portfolio?
- What is the regional distribution network?
- Who are the Targeted market segments?
- What is the attitude towards non-registered businesses, farming and agriculture?
- What are the additional fees and commissions levied on SME loans?
- What are the types of collateral accepted?
- Centralized versus decentralized decision making for loan applications?
- Rate of rejection and reasons for rejection?
- General level of interest and expectations for guarantee facilities; and
- Key challenges to MSME expansion (staff training, funds, MSME sector information, operational, collateral, etc.)?
- What is the current/average Interest rates charged on various financial products (overdrafts, term loans)?
- What is the current Interest paid to saving deposits?

Appendix 11: Detailed Methodology

A. Estimation of total demand of formal credit:

Below approach was used to calculate the total demand of formal credit

1. Total sample formal credit demand of NPR 1.62 billion (USD 14.7 million) was computed considering the total sample size of 451 MSMEs.
2. Size of the sample was segregated into 2 parts as described in the diagram below.

```
Total sample size (451; 100%)

 Respondents considering future investment (324; 72.1% )  Respondents not considering future investment (127; 28.9%)
```

Based on the information sample size of 324 is considered to calculate the total demand

3. Considering the descriptive information from the sample, population size of 208,550 was computed by deducting 28.9% from the actual size of total MSMEs (i.e. 290,459) registered at DOCIS.
4. Computation of the sample demand represented \( \frac{324}{208,550} \) 0.15% of the total demand and based on the information overall demand of NPR 1043 billion (USD 9.46 billion) was calculated.

\[
Total\ demand = \frac{Sample\ demand}{0.1553} \times 100
\]

B. **Estimation of demand according to geographical specificities:**

Below approach was used to calculate the total demand according to geographical specificities:

1. Geographical specificities was divided into Hill, Terai and Mountain.
2. Total sample demand (as given in the figure below) of Hill, Terai and Mountain was calculated based on the provided sample.

3. Percentage demand was calculated based on the information as provided in step 2 above.
4. Same percentage figure as calculated in step 3 was used to compute total demand for each geographical specificities.

\[ \text{Total demand} = \frac{\text{Sample demand according to geographical specificities}}{\text{Respective percentage contribution}} \times 100 \]

C. Estimation of formal credit demand according to size:

Below approach was used to calculate the total demand according to size:

1. Size was divided into Small, Micro and Others.
2. Total sample demand of Small, Micro and Others was calculated based on the provided sample.
3. Percentage demand was calculated based on the information as provided in step 2.
4. Same percentage figure as calculated in step 3 was used to compute total demand according to size.

\[ \text{Total demand} = \frac{\text{Sample demand according to size}}{\text{Respective percentage contribution}} \times 100 \]

D. Estimation of demand according to sector:

1. Sector was segregated into Agriculture, Service, Manufacturing, Tourism, and Others.
2. Total sample demand of each sector was calculated based on the provided sample.

3. Percentage demand was calculated based on the information as provided in step 2.
4. Same percentage figure as calculated in step 3 was used to compute total demand for each sector.

\[
\text{Total demand} = \frac{\text{Sample demand according to sector}}{\text{Respective percentage contribution}} \times 100
\]

E. Estimation of demand according to province and sector:

1. By considering the sample data, percentage demand for each sector was computed. For instance, percentage contribution of agriculture in province 1 is computed to be 42% (118,000,000/284,160,524). Likewise, percentage contribution of service in province 2 is 11% (82,000,000/769,900,000).

Provinces (segregation of amount)

<table>
<thead>
<tr>
<th>Sector wise</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>118,000,000</td>
<td>38,600,000</td>
<td>39,960,524</td>
<td>5,800,000</td>
<td>72,500,000</td>
<td>2,000,000</td>
<td>7,300,000</td>
<td>284,160,524</td>
</tr>
<tr>
<td>Service</td>
<td>240,700,000</td>
<td>82,000,000</td>
<td>189,700,000</td>
<td>32,500,000</td>
<td>206,150,000</td>
<td>2,020,000</td>
<td>16,830,000</td>
<td>769,900,000</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>3,800,000</td>
<td>70,000,000</td>
<td>33,800,000</td>
<td>9,000,000</td>
<td>163,650,001</td>
<td>4,100,000</td>
<td>10,500,000</td>
<td>294,850,001</td>
</tr>
<tr>
<td>Tourism</td>
<td>24,500,000</td>
<td>54,000,000</td>
<td>41,800,000</td>
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<td>109,000,000</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Others</td>
<td>1,800,000</td>
<td>10,000,000</td>
<td>21,600,000</td>
<td>3,300,000</td>
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<td>1,000,000</td>
<td>2,000,000</td>
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<td>Total</td>
<td>388,800,000</td>
<td>254,600,000</td>
<td>326,860,524</td>
<td>51,600,000</td>
<td>552,300,001</td>
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Provinces

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<th>1</th>
<th>2</th>
<th>3</th>
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<th>5</th>
<th>6</th>
<th>7</th>
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<td>0.25</td>
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<td>0.53</td>
<td>0.08</td>
<td>0.02</td>
<td>0.02</td>
<td>0.05</td>
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</table>
2. Same percentage figure (as computed in table above) was used to distribute total sectorial demand (which is also extracted from estimation of demand according to sector) according to province and sector.

3. With the figure in place the summation of sectorial demand for each province was done to compute the demand for the province (shown in table below). For instance, formal credit demand in province 1 for agriculture, service, tourism, manufacturing and others was summed to calculate total demand for province 1.

<table>
<thead>
<tr>
<th>Provinces</th>
<th>Sector wise</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>Total</th>
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<td>24.86</td>
<td>25.74</td>
<td>3.74</td>
<td>46.69</td>
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<td>4.70</td>
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<td>Service</td>
<td>155.02</td>
<td>52.81</td>
<td>122.17</td>
<td>20.93</td>
<td>132.77</td>
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<td>10.84</td>
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<td>Manufacturing</td>
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<td>45.08</td>
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<td>105.40</td>
<td>2.64</td>
<td>6.76</td>
<td>189.89</td>
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<td>34.78</td>
<td>26.92</td>
<td>0.64</td>
<td>70.20</td>
<td>0.00</td>
<td>0.00</td>
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<td>Others</td>
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<td>6.44</td>
<td>13.91</td>
<td>2.13</td>
<td>0.64</td>
<td>0.64</td>
<td>1.29</td>
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<td>210.51</td>
<td>33.23</td>
<td>355.70</td>
<td>5.87</td>
<td>23.59</td>
<td>1043.28</td>
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**Appendix 12: Distribution of Samples across Sectors**

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<th>Region</th>
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<th>Manufacturing</th>
<th>Agriculture</th>
<th>Service</th>
<th>Tourism</th>
<th>Others</th>
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<td>5</td>
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<td>10</td>
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<tr>
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<td>Makwanpur (Hetauda)</td>
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<td>16</td>
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<tr>
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<td>0</td>
<td>0</td>
<td>7</td>
<td>74</td>
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<td>Dang</td>
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<td>7</td>
<td>0</td>
<td>0</td>
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<td>74</td>
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</tr>
<tr>
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<td>0</td>
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<td>Kailali (Dhangadi, Tikapur)</td>
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Total | 102 | 93 | 211 | 23 | 22 | 451 |

Demand Study on MSME Financing