

# EVALUATING BI'S FINANCIAL SERVICES PORTFOLIO

Reviewing the impact of MSME and business financing in Nepal – a case study of NMB



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# Acronyms

<b>ATM</b>	Automated Teller Machine
<b>BII</b>	British International Investment
<b>CAGR</b>	Compounded Average Growth Rate
<b>DFI</b>	Development Finance Institution
<b>DI</b>	Development Impact Thesis
<b>FI</b>	Financial Institution
<b>FY</b>	Financial Year
<b>GDP</b>	Gross Domestic Product
<b>GoN</b>	Government of Nepal
<b>LIBOR</b>	London Interbank Offered Rate
<b>MSME</b>	Micro, Small and Medium Enterprises
<b>NPL</b>	Non-Performing Loan
<b>NPR</b>	Nepalese Rupee
<b>NRB</b>	Nepal Rastra Bank
<b>ODBL</b>	Om Development Bank Limited
<b>SME</b>	Small and medium enterprise
<b>USD</b>	United States Dollar

# Executive summary

## Rationale and context of the study

In 2019, the Foreign, Commonwealth & Development Office (FCDO) commissioned Genesis Analytics and IPE Global to independently evaluate British International Investment's (BII) Financial Institutions portfolio (renamed Financial Services).

The purpose of this evaluation is to better understand the development outcomes and impacts associated with BII's investments in the financial services sector. It consists of two phases, namely an evidence and portfolio-level review completed in 2020 (phase one), and a subsequent series of in-depth case studies (phase two).

The phase one review revealed that while lending to Micro, Small and Medium Enterprises (MSMEs) by BII investee banks had grown in absolute terms, growth for most banks had stagnated as a share of the loan book. It also revealed that BII's investments in banks were focused on financing MSMEs and that it is important to understand the impact of this financing at a borrower level.<sup>1</sup>

As such, the evaluation team identified MSMEs as an area of interest for an in-depth study.

This report presents the findings of one in-depth case study, exploring BII's investment in NMB, one of the leading commercial banks in Nepal with a strategic focus on MSME financing. The development impact (DI) thesis underpinning the loan to NMB Bank Limited (NMB) is presented below.

### Box 1: Development impact thesis (2018)

"BII (at the time of the investment known as CDC) will be one of the first investors to provide long-term hard currency financing to a bank in Nepal following the removal of regulation in March 2018, enabling NMB to on-lend to agriculture, infrastructure, microfinance, and foreign currency earning sectors (as prescribed by Nepal Rastra Bank (NRB) - the central bank of Nepal)."

In 2019, the DI thesis was updated to reflect the reality of the market context and actual need for capital in the Nepalese market. The updated DI thesis is presented below.

### Box 2: Development impact thesis (2019)

BII's USD 15m, 3-year loan to NMB will enable the bank to increase its productive lending to domestic Small and Medium Enterprises (SMEs) and mid-sized corporates with either local or foreign currency requirements. The borrowers will be able to meet their capital needs, allowing them to manage production of goods and services to the domestic market."

By updating the DI thesis to specify lending to SMEs, BII and NMB's objectives were aligned, as the bank had been increasing its focus on MSME lending with the aim of growing the share of its total loan portfolio to MSMEs.

In 2022, BII updated its approach to impact management and introduced the Productive, Sustainable, and Inclusive (PSI) framework to inform investments covering its 2022 - 2026 strategy period.<sup>2</sup> While this framework was not in place at the time of the investment, the aims of the investment in NMB remain well-aligned to the new strategy.

1  Sunderji, S., Williams, D., Fuchs, M., Wyatt, A., Verrinder, N., (2020). Evaluating CDC's financial institutions portfolio. Genesis Analytics and IPE Global.

2  British International Investment. (2022). Productive, Sustainable and Inclusive Investment 2022 - 26 Technical Strategy.

## Evaluating the impact of MSME and business financing in Nepal – a case study of NMB

This study focuses on the direct debt investment made by BII in 2018 in NMB and has two main objectives: (i) to understand the role of banks in addressing the challenges faced by MSMEs, using BII's direct debt investments in NMB as a case study, and (ii) to understand the impact of such investments on borrower business expansion.

The study utilised a mixed methods approach: (i) desk research to gain an understanding of the Nepalese banking industry, its regulatory environment, and compare the performance of NMB and other commercial banks; (ii) review of BII's internal monitoring data and NMB's internal data to understand how BII's investment was used, and to assess its performance and possible impact on its borrowers; (iii) interviews with the BII investment team, NMB senior management, two mid-sized corporates and 48 MSMEs. The four evaluation questions are presented below, along with summaries of findings and lessons drawn from the study.

### QUESTION 1: What are the outcomes of BII's investment in NMB?

**Finding 1.1:** BII's investment in NMB allowed the bank to extend its reach to MSMEs and mid-sized corporates during periods of tight domestic liquidity.

Nepal has repeatedly faced liquidity shortages due to the central bank's efforts to peg the stable exchange rate to the Indian Rupee, alongside a chronic current account deficit.<sup>3</sup> The \$15 million loan provided to NMB offered some temporary relief with regard to such liquidity constraints.<sup>4</sup>

Around 48 per cent of BII's investment in NMB was disbursed in USD loans to two local mid-sized corporates: Hotel 1, a family-owned hotel, and Hotel 2, which is part of an international conglomerate.<sup>5</sup> The remaining 52 per cent of the funds were on-lent by NMB in Nepalese Rupee (NPR) to MSMEs.<sup>6</sup>

During the three-year period of BII's funding commitment (FY 18/19 to FY 21/22), NMB's MSME loan book grew from approximately NPR 29 billion (\$232 million) to NPR 54 billion (\$432 million), exhibiting a compound annual growth rate (CAGR) of 23 per cent.<sup>7,8</sup> However, despite the absolute growth in SME lending, the proportion of NMB's overall lending devoted to MSMEs remained unchanged at around 30.5 per cent, only slightly up from 29 per cent in FY 17/18 (prior to BII's loan disbursement to NMB).<sup>9</sup>

While BII did contribute to strong growth, substantial liquidity from alternative sources would have been necessary for NMB to expand its share of the total loan portfolio dedicated to MSMEs, and apart from liquidity constraints, NMB could have faced challenges in managing credit risks associated with a significant increase in the proportion of its lending devoted to MSMEs.

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3  Shrestha, S., (2022). The ongoing liquidity crisis in Nepal. Nepal Economic Forum.

4 Stakeholder engagements, 2022, NMB Management Team Interviews

5 Ibid

6 Ibid

7 NMB, 2022, Internal database.

8 Note: NMB's financial year is from July to June. The report uses the average exchange rate for 2022: 1 \$ = 125 NPR for all currency conversions. Average inflation rate between 2018-2021 in Nepal was 4.6 per cent.

9 NMB, 2022, Internal database.

### Lesson 1.1.1: DFIs can play an important role in supporting local FIs to finance priority sectors

DFIs like BII can play a significant role in financing prioritized sectors, contributing to sustainable economic growth and providing much-needed funding. BII's loan to NMB was crucial in enabling the bank to access additional liquidity, allowing it to extend credit to priority sectors identified by the Government of Nepal, namely MSMEs and the tourism sector.<sup>10</sup> The emphasis on priority sectors was specifically designed to ensure that the credit resources would be directed to productive investments, ultimately supporting the government's GDP growth target.<sup>11</sup>

### Lesson 1.1.2: DFIs can play a crucial role in addressing funding gaps in markets that face liquidity constraints

BII's investment served as a source of liquidity for NMB, relieving the Bank from liquidity constraints and supporting it in offering credit to the market. However, as noted in finding 1.2, NMB did have to manage the foreign currency risk associated with the loan from BII.

### Lesson 1.1.3: DFIs should consider the capacity of financial institutions when making investments

DFIs should carefully evaluate the capacity of financial institutions and it may be advisable to provide them with technical assistance when necessary. One area where these institutions may benefit from support is in their capacity to evaluate risks in lending to MSMEs.

**Finding 1.2:** BII's investment in NMB proved to be instrumental for the bank, despite the challenges it faced in managing foreign currency risk

While BII's investment facilitated lending in a liquidity constrained economy, the evaluation revealed that foreign currency loans posed difficulties for NMB due to the currency mismatch between its USD-denominated liabilities (i.e., BII's investment) and its NPR-denominated assets (NMB's loans).

In the case of the two hotels, NMB was able to pass on the currency risk to its borrowers since the hotels generate USD-denominated revenues. However, even in this scenario, these exposures proved to be risky during the pandemic when the hotels' dollar revenues significantly declined, affecting their ability to repay. On the other hand, MSMEs are unlikely to generate foreign currency-denominated revenues, which means that NMB would either need to hedge the currency risk to the extent possible or bear the risk itself.

<sup>10</sup> [Thapa, S., \(2019\). Priority sector lending in Nepal: Importance and complication. Investropaper.](#)

<sup>11</sup> National Business Institute, 2018, Priority Sector Lending.

## Lesson 1.2: DFIs should strive to provide funding in the local currency to financial institutions in emerging markets, where possible

Due to the currency mismatch when lending in foreign exchange, DFIs should prioritize efforts providing liquidity in the local currency, particularly when it comes to lending to MSMEs in emerging markets, which are unable to hedge currency exposure, as they are unlikely to be earning foreign exchange.

In this case, it would be beneficial for NMB, if DFIs like BII could offer liquidity in the local currency. By offering funding in the local currency (NPR in this case), DFIs could help mitigate the challenges faced by their investees in managing foreign currency risk.

### QUESTION 2: Was NMB successful in reaching and serving MSMEs and what types of MSMEs have been reached?

**Finding 2.1:** BII's loan to NMB had a positive impact on the bank's ability to increase the number of loans extended to MSMEs, primarily located in urban areas, and operating within the wholesale and retail trade sectors

During the period of BII's loan investment (2018-2022), the number of MSME borrowers grew at a CAGR of 22 per cent.<sup>12</sup> Although the majority of MSME borrowers (59 per cent) were based in urban areas, NMB's outreach to businesses in rural areas also grew, increasing from 32 per cent in FY 18/19 to 41 per cent in FY 20/21.<sup>13</sup>

Regarding sector distribution, the wholesale and retail trade sectors accounted for the largest share of MSME borrowers, comprising 56 per cent. This was followed by 4.6 per cent of MSME borrowers in the residential business sector.<sup>14</sup>

## Lesson 2.1: When the objectives of the DFI and the FI are aligned, this significantly enhances the likelihood of achieving the intended impact of the funding

The alignment of objectives between the DFI and the FI enhances the likelihood that support provided will be impactful. This alignment will facilitate the efficient allocation of financial resources to projects and initiatives that support the overall development objectives of the investee and the DFI, thereby contributing to positive economic outcomes for target sectors and groups.

In the case of BII, its updated development impact thesis aimed to increase lending to MSMEs, which coincided with NMB's strategic focus on expanding its MSME portfolio.

**Finding 2.2:** NMB's ability to reach MSMEs, particularly those in rural areas, can be attributed to the bank's scale, customer services, and physical presence across all of Nepal's provinces

NMB's growth in footprint has been facilitated by mergers and acquisitions, allowing the bank to establish a robust regional presence relative to other players in the Nepalese banking sector.<sup>15</sup>

According to interviews conducted, the top three reasons cited by MSMEs for choosing NMB as their banking partner were good customer service (37 per cent), referrals from friends or family members (24 per cent), and the convenient location of NMB branches (16 per cent).<sup>16</sup> The size of NMB's operations and its physical presence across all provinces of Nepal have generated powerful network effects, making it easier for the bank to attract new borrowers and provide them with services, including those in rural areas. Furthermore, NMB's strong repu-

<sup>12</sup> NMB, 2022, Internal database.

<sup>13</sup> Ibid

<sup>14</sup> Ibid

<sup>15</sup>  NMB. 2018-19 Annual report.

<sup>16</sup> Stakeholder engagements, 2022, MSME Interviews | Note: The key informant interviews conducted with MSMEs were designed in a way that respondents were not limited to a pre-determined list of answers. They had the freedom to provide as many responses as they wished to the questions posed. The data cited in this context are based on the evaluation team's interpretation of the interview results.

tation for delivering quality customer service has played a significant role in acquiring more borrowers through referrals.

**Lesson 2.2: When selecting investees, several key factors should be taken into consideration, including good customer service, a strong reputation, and a relatively sizable physical and technological presence**

Customer service, a strong reputation, and a relatively sizable physical and technological presence play a crucial role in attracting new borrowers, especially when there is an existing pool of satisfied borrowers who can vouch for the provider. Additionally, the capacity and strategic placement of a bank's physical and technological infrastructure in comparison to its competitors are important considerations.

In an era of increasing digitalisation and branch rationalisation, in making investment decisions DFIs should pay heed to the investee's physical and technological infrastructure relative to other players in the market, as well as the investee's ability and willingness to expand its services to reach underserved segments.

**QUESTION 3: How have NMB's financial offerings impacted their MSME and mid-sized corporate borrowers?**

**Finding 3.1:** The loans provided by NMB had a significant impact on the business expansion of the borrowers interviewed; 91 per cent of MSMEs and mid-sized corporates reported experiencing some form of expansion as a result of the loans provided.

MSME borrowers were able to utilize the loan funds for various purposes. This included financing capital expenditure (29 per cent), supporting working capital needs (21 per cent), purchasing additional raw materials (21 per cent), and hiring more workers (16 per cent).<sup>17</sup> Similarly, the hotels that received USD loans from NMB were able to renovate and expand, as well as hire additional employees.<sup>18</sup> It is important to note that loans by NMB using the liquidity provided by BII were mainly disbursed prior to the COVID-19 pandemic.

In addition to financial support, NMB also provided non-financial assistance to a small portion (10 per cent) of the interviewed MSME borrowers and Hotel 1.<sup>19</sup> This support was in the form of advice on dealing with the effects of the pandemic and resolving business-related issues. Although the extent of support received by borrowers could not be quantified, those who benefited from non-financial assistance confirmed that such non-financial support had a positive effect on their businesses. This support was provided informally based on the relationship between the borrower and NMB's relationship manager.

**Lesson 3.1: While financing plays a crucial role, borrowers highly value additional forms of support beyond financial assistance**

It is important that DFIs consider supplementing financial services with non-financial support, as solely providing funding may not yield optimal results. Assisting MSMEs in preparing required financial statements and project budgets can greatly enhance their prospects of obtaining loans, thus contributing to loan growth.

Non-financial support played a significant role in helping NMB to effectively expand its MSME portfolio.

<sup>17</sup> Stakeholder engagements, 2022, MSME Interviews.

<sup>18</sup> Stakeholder engagements, 2022, Mid-corporates Interviews

<sup>19</sup> Stakeholder engagements, 2022, MSME Interviews | Stakeholder engagements, 2022, Mid-corporate Interviews

#### **QUESTION 4: How were MSMEs and mid-sized corporates impacted by COVID-19 crisis and what strategies worked to ensure business sustainability (for NMB and their customers)?**

**Finding 4.1:** The impact of the pandemic had a similar effect on all NMB borrowers, leading to significant revenue losses due to the national lockdown. However, the strategies adopted to cope with the situation varied among businesses

During the pandemic, approximately 30 per cent of the interviewed MSMEs temporarily suspended their operations, while 53 per cent experienced a notable decline in revenues.<sup>20</sup> Considering the 30 per cent of businesses that had to shut down their operations for more than six months, the overall percentage of MSMEs facing a revenue decline was 73 per cent.<sup>21</sup> The effects were also felt by mid-sized corporates, such as Hotel 1, which had to completely cease its operations during the peak of the pandemic. Additionally, Hotel 2 witnessed a mere 4 per cent occupancy rate.<sup>22</sup>

During these challenging times approximately 37 per cent of the interviewed MSME customer of NMB encountered difficulties in accessing finance.<sup>23</sup> To support these businesses, NMB implemented measures such as loan restructuring and interest rate reductions in alignment with the directives of the NRB. Furthermore, around 27 per cent of MSMEs were able to access additional loans from NMB.<sup>24</sup> For instance, one of the coping mechanisms employed by Hotel 1 was to secure an NPR loan from NMB to sustain its operations during the pandemic. On the other hand, Hotel 2, being part of a conglomerate, managed to generate funds by liquidating assets from other businesses, enabling the hotel to survive without additional borrowing despite the adverse circumstances.

#### **Lesson 4.1: Disparities in access to finance between MSMEs and mid-size corporates resulted in greater impact on the solvency and profitability of MSMEs than on mid-size corporations during the COVID-19 pandemic**

During the pandemic it became evident that local, smaller businesses required greater support than larger businesses. Unlike their larger counterparts, small businesses often lack alternative financing options. As a result, they are more vulnerable to financial strains and are likely to resort to liquidity support through bank lending.

To prevent business disruption caused by short-term financial pressures and avert economic disruptions during times of strain or crisis, there is a strong rationale for DFIs to prioritize directing financial support towards smaller businesses.

<sup>20</sup> Stakeholder engagements, 2022, MSME Interviews

<sup>21</sup> Note: An anomaly observed during data collection is that a number of respondents who had to shut down operations due to the pandemic did not mention a revenue decline as one of the effects on their businesses. Considering that shutting down operations inevitably leads to a revenue decrease, the proportion of MSMEs interviewed that experienced a revenue decline increases to 73 per cent.

<sup>22</sup> Stakeholder engagements, 2022, Mid-corporate Interviews

<sup>23</sup> Stakeholder engagements, 2022, MSME interviews

<sup>24</sup> Ibid

# 1 | Introduction

## 1.1 Study rationale

In 2019, the Foreign, Commonwealth & Development Office (FCDO) commissioned Genesis Analytics and IPE Global to independently evaluate British International Investment's (BII) Financial Institutions portfolio (renamed Financial Services).

The purpose of this evaluation is to better understand the development outcomes and impacts associated with BII's investments in the financial services sector. It consists of two phases, namely an evidence and portfolio-level review completed in 2020 (phase one), and a subsequent series of in-depth case studies (phase two). This report presents the findings of one in-depth case study, exploring BII's loan to NMB Bank Limited (NMB) one of the leading commercial banks in Nepal with a strategic focus on MSME financing.

The phase one review revealed that lending to Micro, Small and Medium Enterprises (MSMEs) by BII investee banks had grown in absolute terms, however, growth for most banks had stagnated as a share of the loan book.<sup>25</sup> It also revealed that BII's investments in banks were focused on financing MSMEs and that it is important to understand the impact of this financing at a borrower level. As such, the evaluation team identified MSMEs as an area of interest for an in-depth study.

At the time of the investment, BII (formerly Commonwealth Development Corporation) used the Financial institution-development impact (FI-DI) framework (see more on this in Section 2.3). In 2022, BII updated its approach to impact management and introduced the Productive, Sustainable, and Inclusive (PSI) framework to inform investments covering its 2022 – 2026 strategy period.

### Box 5: BII's current approach to investment

Through its investments BII aims to support development that is:

Productive – helping the productivity of an economy to ensure a decent standard of living for all.

Sustainable – helping to transform the economy, reducing emissions, and protecting the environment while allowing for adaptation to climate change.

Inclusive – allowing the gains from productivity and sustainability to be shared with poor, marginalised sections of society.

This framework allows BII and FCDO to ensure that investments remain aligned to strategic priorities. Each of the above strands contributes to an overarching Impact Score for each investment. Within each strand, BII focuses on a number of underlying sub-criteria. These are detailed in its latest Investment Policy<sup>26</sup>, which spans 2022 to 2026.

25  Sunderji, S., Williams, D., Fuchs, M., Wyatt, A., Verrinder, N., (2020). Evaluating CDC's financial institutions portfolio. Genesis Analytics and IPE Global.

26  British International Investment. (2021). Investment Policy for the period from 1 January 2022 to 31 December 2026.

## 1.2 Context

In the South Asia region, MSMEs comprise more than 98 per cent of enterprises, employ approximately 70 per cent of the workforce and contribute about 47 per cent to Gross Domestic Product (GDP).<sup>27</sup> The contribution of MSMEs to Nepal's economy is substantial, accounting for 80 per cent of employment, 70 per cent of the total value of exports and 90 per cent of GDP.<sup>28</sup> MSMEs were identified by NRB as an important vehicle for transitioning the economy to industrialisation. However, the financing gap faced by MSMEs is high with only 32 per cent of SMEs and 36 per cent of micro enterprises in Nepal reporting having access to credit in 2018.<sup>29</sup> Exacerbating the low lending capacity of FIs are recurring liquidity shortages in the Nepalese financial sector driven by a history of credit growth outstripping that of deposits.<sup>30</sup>

Exacerbating the low lending capacity of FIs are recurring liquidity shortages in the Nepalese financial sector driven by a history of credit growth outstripping that of deposits.<sup>31</sup> These shortages arise due to the central bank's endeavours to uphold a stable or pegged exchange rate.

Prior to 2018, FIs were not allowed to source foreign currency-denominated credit from non-Nepalese FIs, limiting available funds for on-lending. However, on 3 April 2018, NRB issued a notice that allowed licensed 'Class A' financial institutions (commercial banks) in Nepal to borrow from foreign FIs in convertible foreign currency for up to 25 per cent of their core (or Tier I) capital.<sup>32</sup> According to the NRB's regulation the interest rate on such bank borrowing was capped at the six-month London Interbank Offered Rate (LIBOR) plus a 3 per cent margin.

It was against this backdrop that BII invested in the Nepalese banking sector in 2018 with a \$15 million three-year senior unsecured loan to NMB.<sup>33</sup> The DI thesis underpinning the loan to NMB is presented below.

### Box 3: Development impact thesis (2018)

BII (at the time of the investment known as CDC) will be one of the first investors to provide long-term hard currency financing to a bank in Nepal following the removal of regulation in March 2018, enabling NMB to on-lend to agriculture, infrastructure, microfinance, and foreign currency earning sectors (as prescribed by Nepal Rastra Bank (NRB) - the central bank of Nepal).

At the time of the investment, SMEs were noted to be a priority segment for NMB's lending activities, and BII's DI thesis supported servicing SMEs operating in the priority sectors within NMB's pipeline and current portfolio. Subsequently in 2019, the DI thesis was updated to include SMEs lending, reflecting NMB's strategic focus on supporting MSMEs and the actual demand for financing in the market. The updated DI thesis is presented below.

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27 [UNICEF. \(2021\). Assessing the Impacts of COVID-19 on MSMEs in South Asia and East Asia Pacific in Relation to Child Rights.](#)

[Asad, A., The Role of SMEs in Asia's Economic Growth. SME Finance Forum.](#)

28 [Madan, N., \(2020\). A Review of Access to Finance by Micro, Small and Medium Enterprises and Digital Financial Services in Selected Asia-Pacific Least Developed Countries. UNESCAP.](#)

29 Ibid

30 [Shrestha, S., \(2022\). The ongoing liquidity crisis in Nepal. Nepal Economic Forum.](#)

31 Ibid

32 [Upreti, A., Nepal Rastra Bank allows Class-A banks to borrow from foreign financial institutions. Pioneer Law Associates.](#)

33 [British International Investment. \(2019\). CDC makes first-ever investment in Nepal with US\\$ 15 million loan to NMB.](#)

## Box 4: Development impact thesis (2019)

BII's USD 15m, 3-year loan to NMB will enable the bank to increase its productive lending to domestic Small and Medium Enterprises (SMEs)<sup>34</sup> and mid-sized corporates<sup>35</sup> with either local or foreign currency requirements. The borrowers will be able to meet their capital needs, allowing them to manage production of goods and services to the domestic market.

By updating the DI thesis, BII and NMB's objectives were aligned as the bank had been increasing its focus on MSME lending with the aim of growing the share of its total loan portfolio to MSMEs. In support of this objective and consistent with NRB's guidance, approximately half (48 per cent) of BII's investment was on-lent by NMB in the form of USD loans to two local mid-sized corporates (hotels) with USD revenues generated in the tourism sector, and the remaining 52 per cent of the funds were on-lent by NMB in NPR to MSMEs.<sup>36</sup> NMB managed currency risk through various strategies, including hedging, transferring the risk to its borrowers, or assuming a portion of the risk. In situations where borrowers generated revenues in US dollars, lending in USD proved to be less risky. This was particularly evident in the case of the two hotels.

### 1.3 Purpose and method

This study focuses on the direct debt investment made by BII in 2018 in NMB and has these two main objectives: (i) to understand the role of banks in addressing the challenges faced by MSMEs, using BII's direct debt investments in NMB as a case study, and (ii) to understand the impact of such investments on borrower business expansion. This study, therefore, seeks to answer four key questions, shown below.

**Table 1: Key in-depth study questions**

#	Questions
1	What are the outcomes of BII's investment in NMB?
2	Was NMB successful in reaching and serving MSMEs and what types of MSMEs have been reached?
3	How have NMB's financial offerings impacted their MSME and mid-sized corporate borrowers?
4	How were MSMEs and mid-sized corporates impacted by the COVID-19 crisis and what strategies worked to ensure business sustainability (for NMB and their customers)?

<sup>34</sup> Note: NMB differentiates between Micro businesses and SMEs. Micro businesses are defined as entities with a loan exposure of below NPR 10 million (\$ 80,000), and SMEs as entities with a loan exposure ranging from NPR10 million to NPR 50 million (\$ 80,000 – 400,000). Going forward, where it is necessary to distinguish between sizes, terms such as micro and SME are used to indicate different segments of the overarching group, otherwise MSMEs is used in reference to both micro and SME businesses. The DI thesis did not explicitly target micro businesses and focuses on SMEs and mid-sized corporates.

<sup>35</sup> Mid-sized corporates are defined by NMB as businesses with a loan exposure between NPR 50 million to NPR 200 million (\$ 400,000 – \$ 1,600,000).

<sup>36</sup> Stakeholder engagements, 2022, NMB Management team interviews.



These questions are answered using a mixed methods approach: (i) desk research to gain an understanding of the Nepalese banking industry, its regulatory environment, and compare the performance of NMB and other commercial banks; (ii) review of BII's internal monitoring data and NMB's internal data to understand how BII's investment was used and to assess its performance and possible impact on its borrowers; and (iii) interviews with the BII investment team, NMB senior management, two mid-sized corporates and 48 MSMEs. Recent empirical research suggests that the marginal benefit, or the additional information gained, from stakeholder engagements diminishes as the number of in-depth interviews surpasses a sample size of approximately 12.<sup>37</sup> For the purpose of this study, a sample size of 16 interviews per segment (micro, small, and medium businesses) was chosen to ensure additional robustness. This brought the total number of interviews to 48.<sup>38</sup>

The study encountered some limitations and assumptions, which are outlined below:

Isolating the impact of BII's loan to NMB on the bank's MSME loan book from other DFIs and the government's COVID-19 relief grant was not feasible because of the unavailability of segregated data on the funds received by NMB to specifically support this segment.

1. Isolating the impact of BII's loan to NMB on the bank's MSME loan book from other DFIs and the government's COVID-19 relief grant was not feasible because of the unavailability of segregated data on the funds received by NMB to specifically support this segment.
2. The data provided by NMB and the BII deal team could not be independently validated. It was assumed that the dataset provided was accurate and valid.
3. Self-reported data introduces the potential for bias in reporting. Borrowers may have had an incentive to provide positive feedback on the financing from NMB, potentially skewing the results.
4. The sample composition did not accurately represent the division of NMB's loan portfolio across sectors, as some MSMEs declined to participate in the study, leading to a distortion in the desired sample composition.

To address these limitations, the study employed multiple sources of information and triangulation to ensure robust findings. While it was not possible to fully mitigate the first limitation, it is unlikely to impact the validity of the findings.

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<sup>37</sup>  Guest, G. et al., (2020). A simple method to assess and report thematic saturation in qualitative research.

<sup>38</sup> Note: Representation of the segments interviewed was affected by the willingness of these businesses to participate. As such a total of 23 interviews with micro businesses was conducted, and another 25 interviews jointly conducted with small and medium enterprises.

# 2 | The outcomes of BII's investment

## 2.1 Changes for NMB

BII's funding reduced the impact of the liquidity constraints on NMB at a time when the market was facing recurring liquidity shortages. The ability to access dollar borrowing allowed the bank to continue to expand its loan book in an environment where banks were struggling to fund their loan book growth. NMB's loan book grew from Nepalese Rupee (NPR) 92 billion (\$ 736 million) to NPR 182 billion (\$ 1.5 billion) from Financial Year (FY) 18/19 to FY21/22 – a compound annual growth rate (CAGR) of 26 per cent and the MSME book grew by an impressive 23 per cent CAGR during the same period from NPR 29 billion (\$ 232 million) to NPR 54 billion (\$ 432).<sup>39,40</sup> The bank's management mentioned BII's loan to NMB contributed to this growth confirming that BII's investment facilitated the implementation of NMB's strategy.<sup>41</sup>

BII's loan provided NMB with the opportunity to expand its support to the economic sectors prioritised by the Government of Nepal (GoN). One notable benefit was the increased capacity of NMB to lend to MSMEs in the tourism sector, as identified by the GoN in supporting the country's economic growth and development.<sup>42</sup> The NRB aimed to support priority lending to ensure that adequate credit would be allocated to productive investments in these key sectors. This approach was aligned with the government's objective of achieving targeted GDP growth by providing liquidity to priority sectors through initiatives like BII's investment in NMB.<sup>43</sup>

BII's US dollar loan played a significant role in strengthening NMB's ability to grow its foreign currency lending portfolio and provided it with access to foreign currency (USD in this case) which other commercial banks in the market may have lacked. Specifically, the bank utilized the funds to provide USD loans to two mid-sized corporations operating in the tourism sector.<sup>44</sup>

While BII's involvement facilitated increased lending in a liquidity-constrained economy, foreign currency lending posed certain risks for banks like NMB. In Nepal and other developing markets, absence of adequate hedging instruments creates challenges. USD lending introduces a mismatch between liabilities (funding) in USD and assets (loans) denominated in NPR. Although NMB benefited from a natural hedge through USD lending to the tourism sector, where borrowers generated foreign currency revenue, the NPR loans provided to the MSME sector inevitably exposed the bank to currency risks. While lending to hotels provided NMB with a natural hedge, as the hotels' incomes are denominated in USD, due to limited access to hedging vehicles, the remaining currency risk arising from NPR loans to MSMEs was borne by NMB.

In the subsequent subsections, the study discusses evidence that sheds light on the impact of BII's contribution to NMB's lending portfolio.

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<sup>39</sup>  NMB. Annual report 2017/18.

<sup>40</sup>  NMB. Annual report 2020/21.

<sup>41</sup> Note: NMB's financial year is from July to June. The report uses the average exchange rate for 2022: 1 \$ = 125 NPR for all currency conversions.

<sup>42</sup> Stakeholder engagements, 2022, NMB Management Team Interviews

<sup>43</sup> National Business Institute, 2018, Priority Sector Lending.

<sup>44</sup> Ibid

<sup>45</sup> Ibid

## 2.1.1 NMB and its MSME portfolio

NMB was established in 1996 as a 'Class C' bank, initially operating as a finance company.<sup>45</sup> However, in 2008, NMB made an application to the NRB for a 'Class A' bank license, which would allow it to function as a commercial bank. Subsequently, NMB's license was upgraded, granting it the status of a commercial bank. Currently NMB is the sixth largest commercial bank in Nepal when measured by the total value of outstanding loans.

**Table 2: NMB key metrics, 2018 and 2021**

Metrics	FY 17/18	FY 20/21	CAGR
Number of branches	110	181	18 per cent
Number of Automated Teller Machines (ATM)	96	137	13 per cent
Number of employees	1,080	1,744	17 per cent

Source: NMB annual reports, FY 17/18; FY 20/21

NMB has a wide range of business accounts exceeding 15,000 in number. These accounts cater to various entities, ranging from micro businesses to large corporations. To ensure convenient access to its services, NMB has been steadily expanding its branch and ATM networks across the country.<sup>46</sup>

NMB's growth in footprint has been facilitated by mergers and acquisitions, allowing the bank to establish a robust regional presence relative to other players in the Nepalese banking sector.<sup>47</sup> In 2019 NMB merged with Om Development Bank Limited (ODBL), which was one of Nepal's largest development banks with a significant network presence in Gandaki Province.<sup>48</sup> This merger solidified NMB's position as the bank with the largest branch network in the province. At present, NMB's branch network extends throughout the nation, serving over 1.5 million customers.<sup>49</sup>

Regarding digital financial services, NMB has made notable strides in leveraging technology platforms to enhance its retail banking department. These platforms facilitate seamless customer onboarding, deposit and lending product subscriptions, and other associated services.<sup>50</sup> NMB offers digital loan products such as the NMB Sapati, an AI-driven loan product tailored for payroll account customers, and the NMB You-Wah Digi Savings, designed specifically to meet the banking needs of the youth population.<sup>51</sup>

Currently, available digital product offerings for MSME borrowers include agriculture loans, microfinance loans, loans targeted at women, and subsidy loans.<sup>52</sup> The maximum loan tenor for working capital loans is five years, while capital expenditure loans have a maximum tenor of ten years.<sup>53</sup>

<sup>45</sup> Finance companies are defined as FIs that accept deposits and perform similar transactions to commercial banks, however, are restricted from performing trade finance and foreign exchange transactions, as well as the provision of hypothecated loans.

<sup>46</sup>  NMB. Annual report 2021/22.

<sup>47</sup> Ibid

<sup>48</sup>  NMB. Annual report 2018/19.

<sup>49</sup>  NMB. Annual report 2021/22.

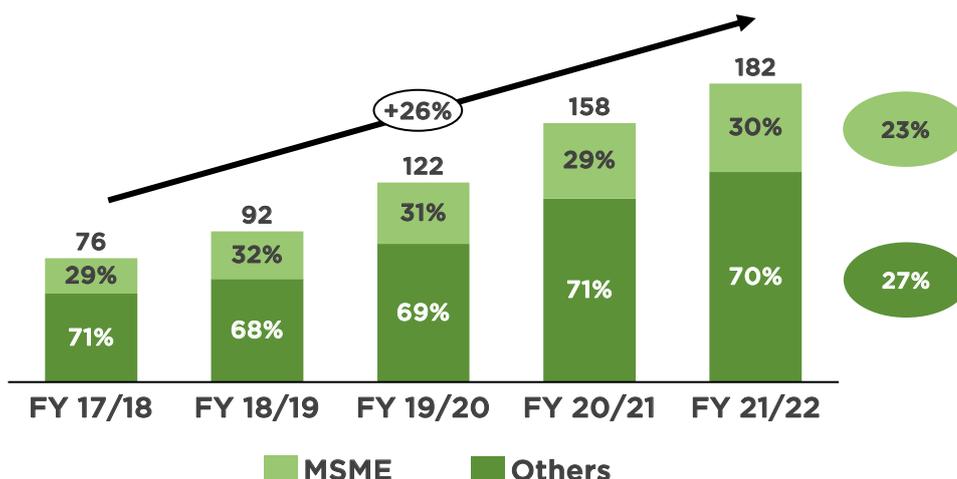
<sup>50</sup> Ibid

<sup>51</sup> Ibid

<sup>52</sup>  NMB, 2022, Products and Services: Loans.

<sup>53</sup> Ibid

**Figure 1: NMB's total value of loans outstanding to borrowers**  
 (The total value of outstanding loans in NPR billions, with a CAGR from FY 18/19 to FY 21/22)



Source: NMB annual reports, FY 2017/18 – FY 20/21 | NMB database

Notes: Others include loans to corporate and mid-corporates, energy loans, microfinance loans and loans to other segments

The total value of loans includes NMB's entire loan book (both NPR and foreign currency loans)

As noted above, NMB's loan book experienced significant growth. Notably, the total value of outstanding loans to MSMEs grew by 23 per cent (CAGR) from approximately NPR 29 billion (\$ 232) in FY 18/19 to NPR 54 billion (\$ 432) in FY 21/22.<sup>54</sup> However, as noted by the evaluation team in the portfolio review undertaken in Phase 1, SME lending has grown in absolute terms, but has been flat relative to the banks' loan portfolios. The share of loans to MSMEs, remained relatively unchanged over the duration of the investment (FY 18/19 – FY 21/22) hovering at an average of around 30.5 per cent, compared with 29 per cent in FY 17/18 (before BII's loan to NMB was disbursed).<sup>55</sup> According to NMB's management, the COVID-19 pandemic contributed to a reduction in the share of loans to MSMEs in FY 19/20 and FY 20/21.<sup>56</sup>

For NMB to experience significant growth in the share of its lending portfolio focused on MSMEs, certain hurdles would need to be overcome. Firstly, alternative sources of liquidity would need to be explored to ensure adequate funds are available for lending to MSMEs. This could involve seeking partnerships or collaborations with other financial institutions or exploring funding options such as securitization or issuance of bonds. Moreover, substantial restructuring of NMB's operational processes would be necessary to better cater to the needs of MSMEs. This could include streamlining loan approval procedures, offering customized loan products tailored to MSME requirements, and providing additional support services such as business advisory or training programs.

NMB's ability to increase the share of lending to MSMEs may have been constrained by the accumulation of credit risks. Rapid expansion of lending to this sector could potentially result in an increase in credit risk exposure for the bank. NMB would need to carefully manage and mitigate these risks through effective risk management practices, including robust credit assessment processes and monitoring mechanisms.

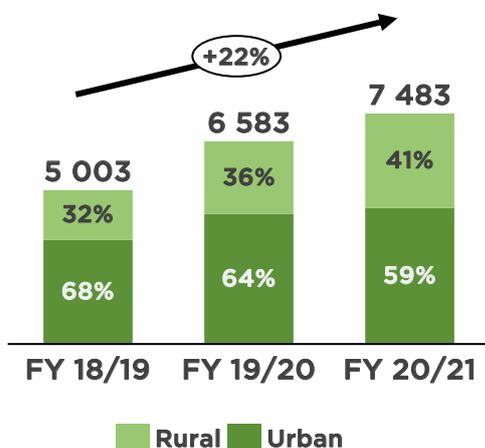
<sup>54</sup> NMB, 2022, Internal database.

<sup>55</sup> Ibid

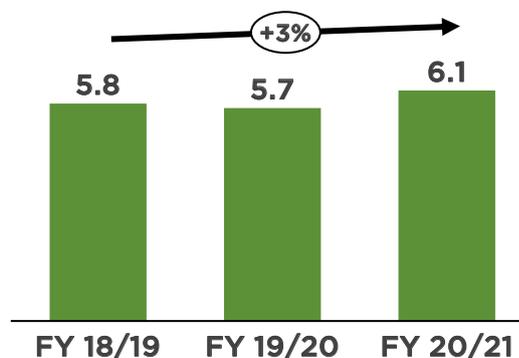
<sup>56</sup> Stakeholder engagements, 2022, NMB Management Team Interviews

Considering the aforementioned challenges, it is unlikely that NMB currently possesses the capacity to manage the significant increase in credit risk associated with rapid expansion of lending to MSMEs. However, by implementing comprehensive risk management strategies, enhancing operational efficiency, gradually building expertise in MSME lending, and engaging in providing MSMEs with business development services, NMB can strengthen its position and gradually increase the share of its lending portfolio dedicated to serving MSMEs.

**Figure 2: Number of MSME borrowers split by region**



**Figure 3: Average loan size for MSMEs (NPR millions)**



Source: NMB database / BII Nepal Deal Team, Quarterly Indicators

Of NMB's loans to MSMEs in FY 20/21, the majority (67 per cent) were to micro businesses and 33 per cent to small and medium enterprises.<sup>57</sup> Figure 2 and Figure 3 above show an increase in the total number of MSMEs receiving loans from NMB. The share of rural borrowers increased from 32 per cent in FY 18/19 to 41 per cent in FY 20/21, possibly a result of NMB's growing outreach as reflected by its growing branch and ATM networks.<sup>58</sup> The average size of loans to MSMEs remained relatively flat, varying from NPR 5.8 million (\$ 46,400) to NPR 6.1 million (\$ 48,800) between FY 18/19 and FY 20/21.<sup>59</sup> Similarly, during the period of investment, the average loan tenor also remained relatively unchanged.<sup>60</sup> Despite short term relaxation in payment of interest and tenure of loan extended to NMB's clients as allowed by NRB, no significant changes in loan size and loan tenor were observed during the pandemic.<sup>61</sup>

NMB's Non-Performing Loans (NPLs) ratio stood at 2.68 per cent in FY 20/21, an increase from 0.82 per cent in FY 18/19.<sup>62</sup> The COVID-19 pandemic and the merger and acquisition of ODBL were the main contributors to the rise in the ratio. As the effects of the pandemic subside, NMB's management indicated that NPLs have gradually started to decrease, and NMB's recently published Annual Report for FY 21/22 shows NPLs declining to 1.45 per cent.<sup>63</sup>

<sup>57</sup> NMB, 2022, Internal database.

<sup>58</sup> Ibidem

<sup>59</sup> Ibidem

<sup>60</sup> Stakeholder engagements, 2022, NMB Management Team Interviews

<sup>61</sup> Ibid

<sup>62</sup> NMB. (2021). Annual report 2020/21. Available at: . Note: It is important to note that the NPL ratio is low/healthy according to international standards. Low NPLs are common in Nepal, the average for commercial banks in Nepal was 1.30 per cent in mid-April 2022.

<sup>63</sup> NMB. (2022). Annual report 2021/22.

**Figure 4: Value of loans outstanding to MSME borrowers split by sector**  
 (The share of total outstanding loans, expressed as a percentage, for the fiscal years FY 18/19 to FY 20/21)



Source: NMB database

In terms of the number of MSMEs receiving loans from NMB, the largest share (56 per cent) of borrowers operates in the wholesale and retail trade sectors, followed by 4.6 per cent in the residential business sector.<sup>64</sup> When considering the value of loans, as depicted in **Figure 4**, the majority of NMB’s lending to MSMEs is concentrated in the wholesale and retail trade sectors, followed by the manufacturing sector.<sup>65</sup> Working capital loans account for the majority of loans to MSMEs, comprising 72 per cent in FY 2021.<sup>66</sup>

<sup>64</sup> Ibid

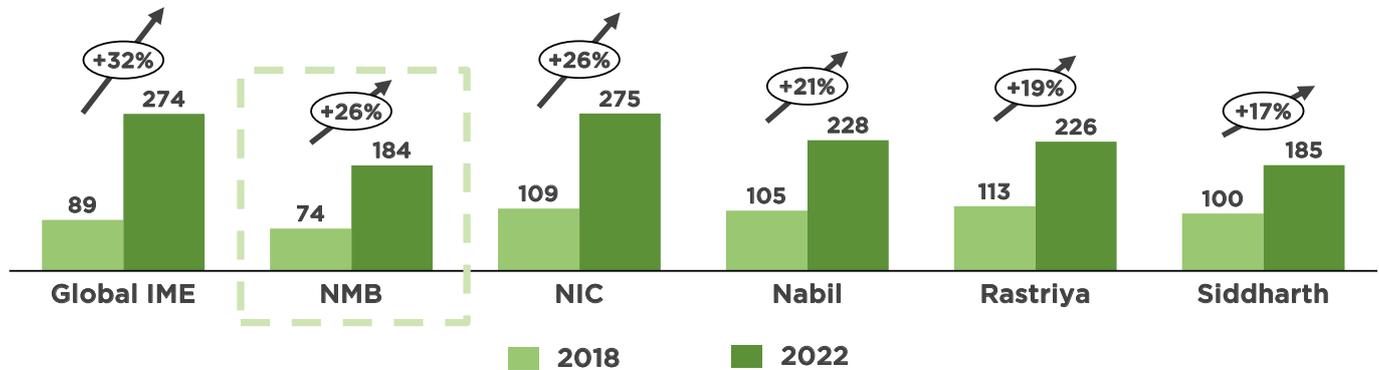
<sup>65</sup> Note: The description ‘wholesale and retail trade’ is the short form for the sector’s full description as categorised by NMB, which is the ‘wholesale and retail trade, vehicle, and motorcycle maintenance services’ sector.

<sup>66</sup> NMB, 2022, Internal database

## 2.1.2 NMB and its peers

Represented below is the performance of NMB compared to its peers, specifically the top 6 banks by loan market share. Collectively, these 6 banks represent 38 per cent of the loans in the banking industry as of April 2022.<sup>67</sup>

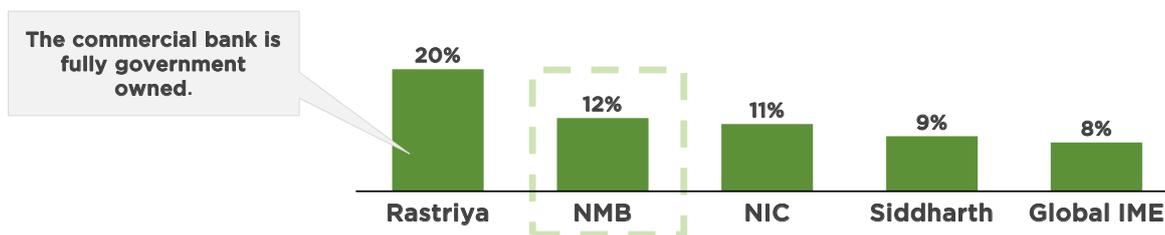
**Figure 5: The total outstanding loans of selected commercial banks, arranged in order of CAGR (The values for loan amount and CAGR are represented in NPR billions and cover the years 2018 and 2022)**



Source: Nepal Rastra Bank, Key Financial Indicators, mid-April 2018, and mid-April 2022<sup>68</sup>

As illustrated in the above figure, from mid-April 2018 to mid-April 2022, NMB exhibited the second fastest growth in total outstanding loans compared to its peer banks.

**Figure 6: The proportion of loans to SMEs (excluding micro and agriculture businesses) for selected commercial banks, measured as a per centage as of mid-April 2022**



Source: Nepal Rastra Bank, Key Financial Indicators, mid-April 2022.

Note: This figure varies from the MSME lending share depicted in Figure 1 as it follows NRB's methodology, which excludes micro businesses from all sectors and MSMEs in the agriculture sector. Therefore, small, and medium businesses that engage in agricultural activities are excluded from the SME category by NRB and included under the agriculture priority sector.

Excluding the government-owned bank, NMB had the highest share of outstanding loans to SMEs as of mid-April 2022, as depicted in Figure 6. According to NMB's management, the bank's loans to SMEs constituted approximately 12.3 per cent of its total loan book, slightly surpassing the NRB's guideline of 11 per cent.<sup>69</sup>

<sup>67</sup> Nepal Rastra Bank. (2022). Key Financial Indicators of Commercial Banks (Provisional).

<sup>68</sup> NRB, 2015 - 2022, Key Financial Indicators of Commercial Banks (Provisional).

<sup>69</sup> Ibid

**Table 3: Lessons learned from BII's investment in NMB**

<b>QUESTION 1: What are the outcomes of BII's investment in NMB</b>
<b>Lesson 1.1.1: DFIs can play an important role in supporting local FIs to finance priority sectors</b> <p>DFIs like BII can play a significant role in financing prioritized sectors, contributing to sustainable economic growth and providing much-needed funding. BII's loan to NMB was crucial in enabling the bank to access additional liquidity, allowing it to extend credit to priority sectors identified by the Government of Nepal, namely MSMEs and the tourism sector.<sup>70</sup> The emphasis on priority sectors was specifically designed to ensure that the credit resources would be directed to productive investments, ultimately supporting the government's GDP growth target.<sup>71</sup></p>
<b>Lesson 1.1.2: DFIs can play a crucial role in addressing funding gaps in markets that face liquidity constraints</b> <p>BII's investment served as a source of liquidity for NMB, relieving the Bank from liquidity constraints and supporting it in offering credit to the market. However, as noted in finding 1.2, NMB did have to manage the foreign currency risk associated with the loan from BII.</p>
<b>Lesson 1.1.3: DFIs should consider the capacity of financial institutions when making investments</b> <p>DFIs should carefully evaluate the capacity of financial institutions and it may be advisable to provide them with technical assistance when necessary. One area where these institutions may benefit from support is in their capacity to evaluate risks in lending to MSMEs.</p>
<b>Lesson 1.2: DFIs should strive to provide funding in the local currency to financial institutions in emerging markets, where possible</b> <p>Due to the currency mismatch when lending in foreign exchange, DFIs should prioritize efforts providing liquidity in the local currency, particularly when it comes to lending to MSMEs in emerging markets, which are unable to hedge currency exposure, as they are unlikely to be earning foreign exchange.</p> <p>In this case, it would be beneficial for NMB, if DFIs like BII could offer liquidity in the local currency. By offering funding in the local currency (NPR in this case), DFIs could help mitigate the challenges faced by their investees in managing foreign currency risk.</p>
<b>QUESTION 2: Was NMB successful in reaching and serving MSMEs and what types of MSMEs have been reached?</b>
<b>Lesson 2.1: When the objectives of the DFI and the FI are aligned, this significantly enhances the likelihood of achieving the intended impact of the funding</b> <p>The alignment of objectives between the DFI and the FI enhances the likelihood that support provided will be impactful. This alignment will facilitate the efficient allocation of financial resources to projects and initiatives that support the overall development objectives of the investee and the DFI, thereby contributing to positive economic outcomes for target sectors and groups.</p> <p>In the case of BII, its updated development impact thesis aimed to increase lending to MSMEs, which coincided with NMB's strategic focus on expanding its MSME portfolio.</p>

<sup>70</sup> Thapa, S., (2019). Priority sector lending in Nepal: Importance and complication. Investropaper.

<sup>71</sup> National Business Institute, 2018, Priority Sector Lending.

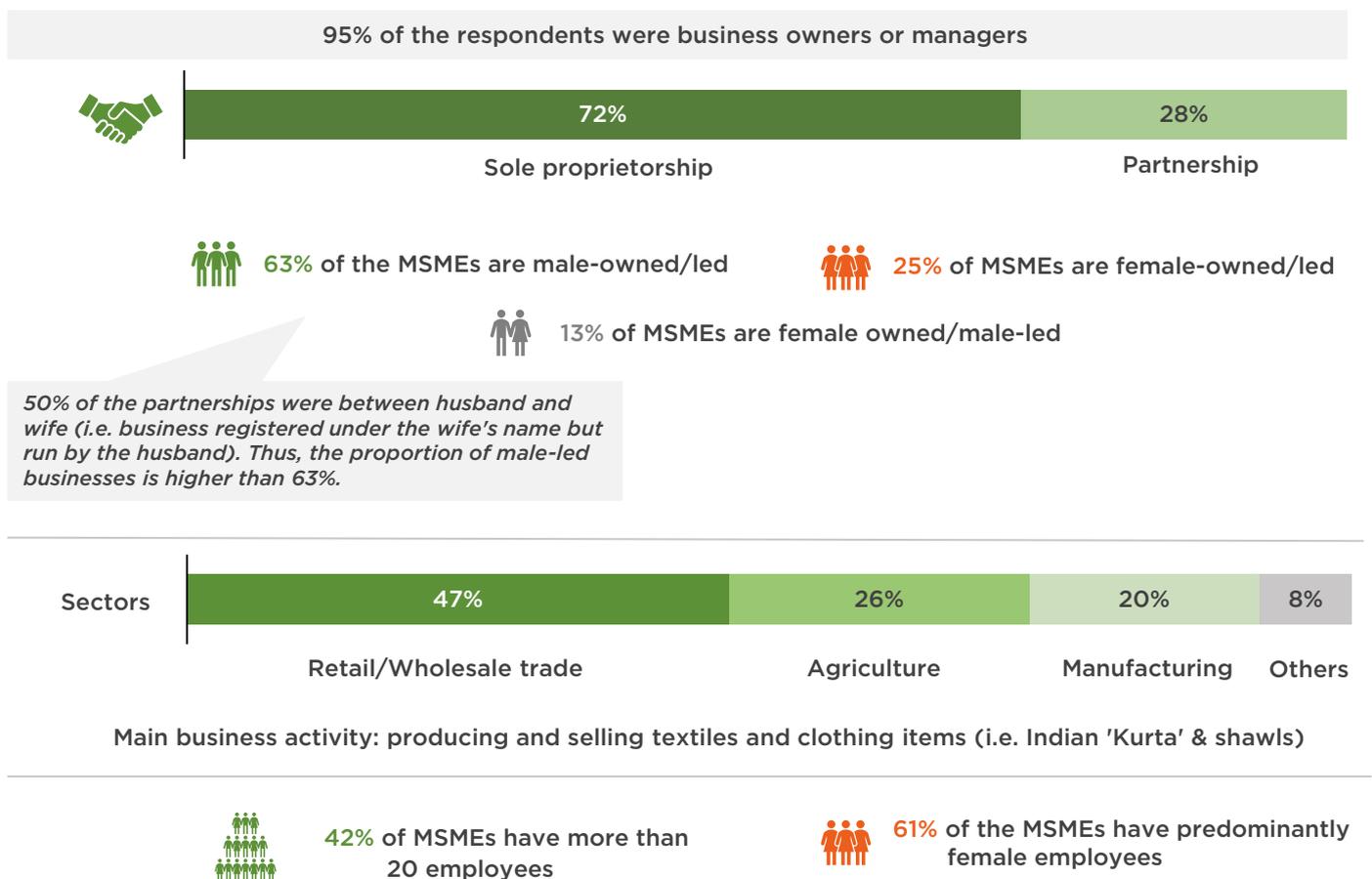
## 2.2 NMB's borrowers

The following section presents the findings derived from interviews conducted with 48 MSMEs and the two mid-sized corporates. The objective of these interviews was to gain insights into the difficulties encountered by borrowers in obtaining financing and the influence of NMB's loans on these segments. Additionally, the interviews addressed the reasons why borrowers choose to bank with NMB, and the role played by NMB in assisting its borrowers during the pandemic.

### 2.2.1 A closer view of NMB's MSME borrowers

The figure below depicts the demographic profiles of the 48 interviewed businesses. While these numbers are not representative (given the qualitative approach of the study) they do provide an indication of the profile of borrowers interviewed.

**Figure 7: Profile of NMB's interviewed MSME borrowers**



*Note: An incentive for family-owned businesses to be registered in the wife's name is possibly the ability to apply for subsidised loans directed at women-owned businesses. The composition of the sample size is not reflective of NMB's MSME lending portfolio in terms of the split by sector the businesses operate in. This is because a number of MSMEs refused to participate in the study and this distorted the desired sample composition.*

## Why MSME borrowers choose NMB

NMB's widespread branch network across all provinces in Nepal has generated significant network effects, making it easier to attract new borrowers. As depicted in **Figure 8**, the primary reasons cited for banking with NMB include perceived good customer service, referrals from family and friends, and the bank's proximity to the customers' businesses.

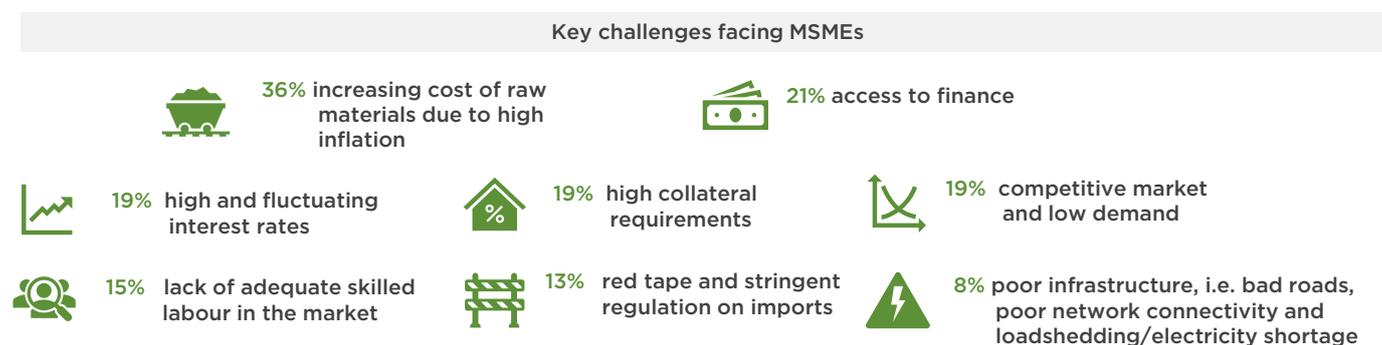
**Figure 8: Reasons why MSMEs choose NMB**



*Note: The Key Informant Interviews (KIIs) allowed respondents to freely provide answers without being limited to a predefined list. They could offer any number of responses to each question.*

## NMB's impact on MSME borrowers

**Figure 9: Challenges faced by MSME borrowers**



*Note: The Key Informant Interviews (KIIs) allowed respondents to provide answers freely, without being restricted to a predefined list. Although respondents had the freedom to share their desired answers, the responses were carefully reviewed and categorised during the analysis phase to ensure consistency and accurate synthesis of information.*

As shown in **Figure 9**, the MSMEs interviewed commonly encountered key challenges such as rising costs of raw materials due to high inflation, limited access to finance, high and fluctuating interest rates, and stringent collateral requirements. These findings align with a 2019 study on MSME financing in Nepal conducted by NRB, which highlighted high and volatile interest rates and stringent collateral requirements as major barriers to accessing finance for most MSMEs.<sup>72</sup>

<sup>72</sup> Nepal Rastra Bank. (2019). Nepalma sana tatha majhaua udhyamma bittiya sadhan parichalan [translates to: SMEs Financing in Nepal].

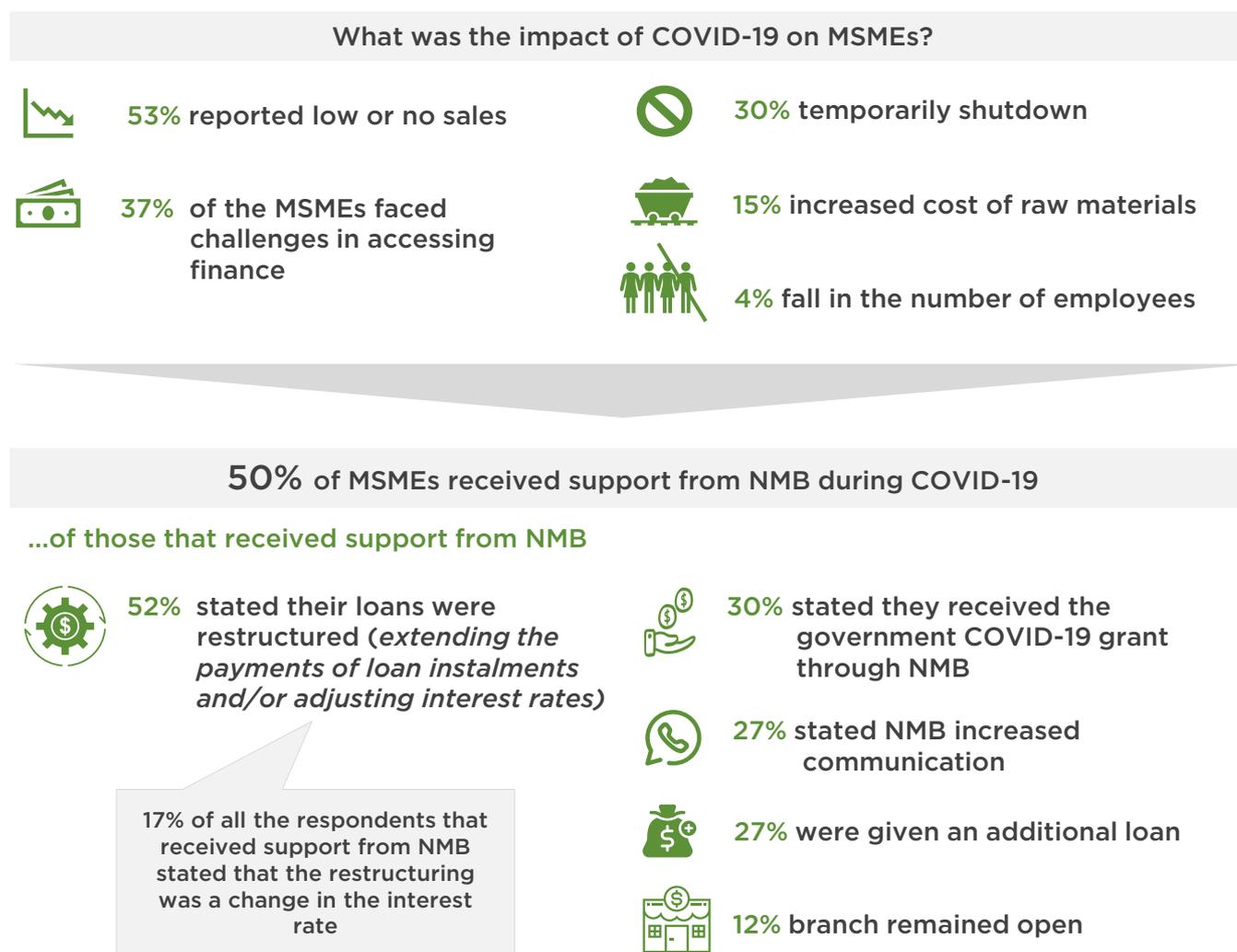
Figure 10: NMB's impact on MSME borrowers



Note: The Key Informant Interviews (KIIs) allowed respondents to provide answers freely, without being restricted to a predefined list. Although respondents had the freedom to share their desired answers, the responses were carefully reviewed and categorised during the analysis phase to ensure consistency and accurate synthesis of information.

Figure 10 reveals that when asked about the impact of credit received from NMB on their businesses, 91 per cent of respondents reported that their loans from NMB resulted in business expansion. The MSMEs elaborated on the specific areas where the credit from NMB facilitated their business growth. Among those who responded, 29 per cent used the loan to purchase machinery, while 15 per cent attributed increased output to their loan. Furthermore, when MSMEs were asked if the loans they received from NMB were sufficient to meet their business needs, more than a third (38 per cent) of respondents expressed the need for an additional loan. However, a significant portion (45 per cent) of respondents mentioned that they lacked the additional collateral required to qualify for another loan. Additionally, a subset of MSME borrowers (10 per cent) received non-financial support from NMB, such as advisory assistance on addressing the impacts of the pandemic or resolving issues affecting their business performance. This non-financial support was primarily provided on an informal basis, reflecting the relationship between individual MSMEs and their NMB client managers.

**Figure 11: Impact of COVID-19 on MSME borrowers and NMB's support during the pandemic**



Note: The Key Informant Interviews (KIIs) allowed respondents to freely provide answers without being limited to a predefined list. They could offer any number of responses to each question.

As shown in **Figure 11**, the pandemic forced a temporary shutdown of operations for 30 per cent of MSMEs and resulted in a revenue decline for 53 per cent of the interviewed MSMEs. Considering the 30 per cent of businesses that had to shut down their operations for more than six months, the overall per centage of MSMEs facing a revenue decline was 73 per cent.<sup>73</sup> These results align with the findings of the COVID-19 Nepal Business Pulse Survey conducted by the IFC and World Bank in partnership with the government of Japan. The Business Pulse Survey revealed that over 80 per cent of 540 representatives from MSMEs across all provinces suffered from a sales slump due to the COVID-19 pandemic.<sup>74</sup>

Thirty per cent of respondents stated that they avoided financial challenges during the pandemic due to the Government's COVID-19 grant for qualifying businesses. In accordance with NRB's directives, NMB also supported MSMEs by restructuring loans and lowering interest rates. Fifty-two per cent of businesses benefited from loan restructuring, and 27 per cent of MSMEs were granted additional loans to sustain their businesses during the pandemic.

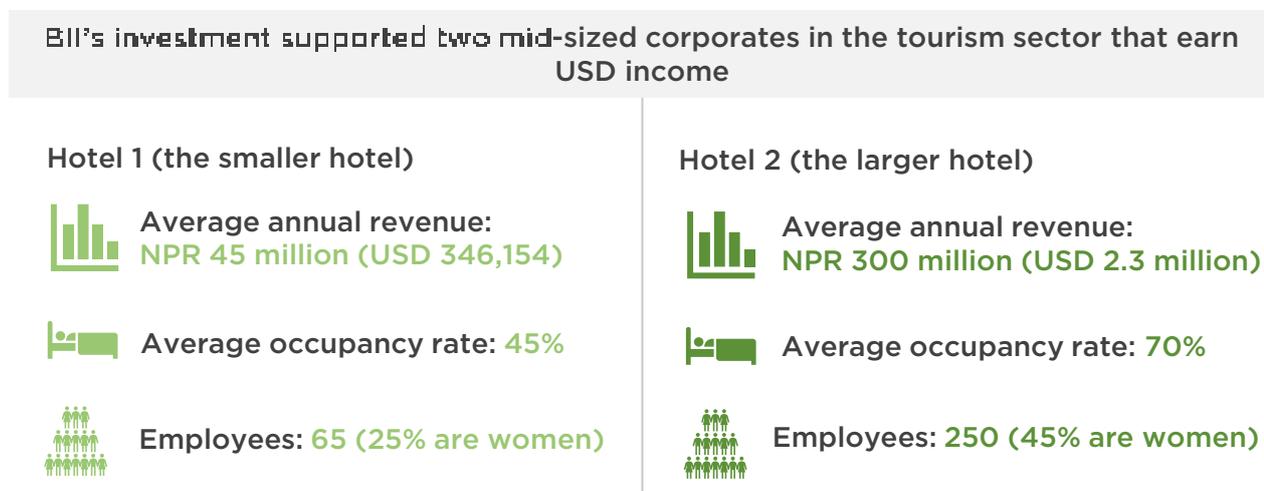
<sup>73</sup> Note: An anomaly observed during data collection is that a number of respondents who had to shut down operations due to the pandemic did not mention a revenue decline as one of the effects on their businesses. Considering that shutting down operations inevitably leads to a revenue decrease, the proportion of MSMEs interviewed that experienced a revenue decline increases to 73 per cent.

<sup>74</sup>  World Bank. (2020). Survey Reveals Extent of the Fallout from the Pandemic on Micro, Small and Medium Enterprises in Nepal.

## 2.2.2 A closer view of NMB's mid-sized corporate borrowers

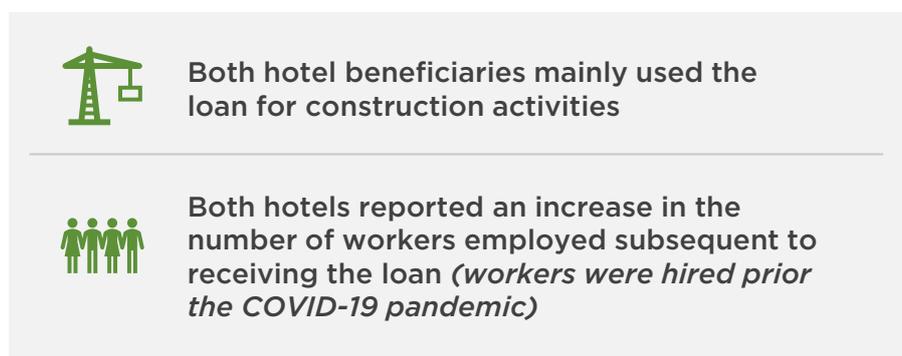
The two mid-sized corporate hotels that received USD loans from NMB are in Nepal's capital city, Kathmandu. The figure below illustrates the distinctive features of these two hotels. Hotel 1 was a local hotel, while Hotel 2 was larger and part of a global chain of hotels.

**Figure 12: Profile of NMB's mid-sized corporate borrowers**



## NMB's impact on mid-sized corporate borrowers

**Figure 13: Impact of NMB's loan on the mid-sized corporate borrowers**

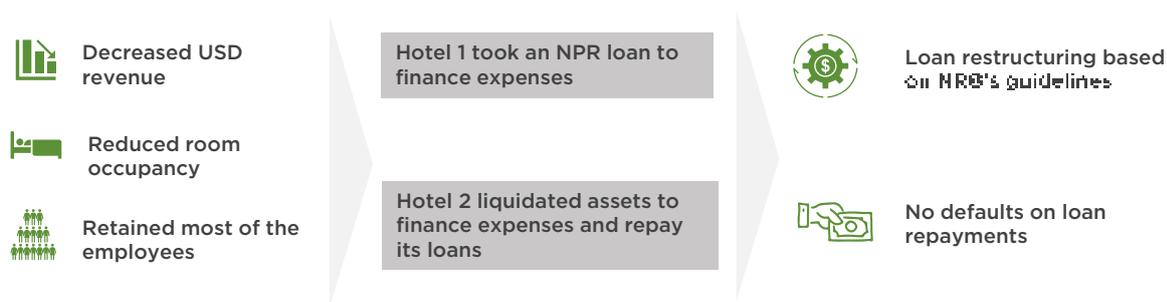


The primary reason that the two hotels chose to bank with NMB was for access to foreign currency (dollars in this case). This was particularly true for hotel 1, which was unable to access USD loans from other banks at a time when the supply of USD loans was limited. The hotels were eligible for USD funding as they were considered capable of bearing any associated foreign currency risks due to their earnings being denominated in foreign currency. As a result of the USD loans, the hotels were able to expand and renovate their buildings. In the years prior to the COVID-19 pandemic the hotels reported that they were able to hire more employees with the help of funding provided by NMB.

In addition to financial support, hotel 1 also received non-financial support in the form of advice on how to manage its expenses and adapt to liquidity shortages, as well as how to ensure compliance with regulatory and policy changes. Similar to non-financial support for MSMEs, the non-financial support provided to hotel 1 was informal, based on the hotel's relationship with the NMB's client manager. The hotel stated that NMB's non-financial support was crucial to its business's success.

To improve its ability to access dollar financing, hotel 1 suggested that NMB should consider reviewing its collateral requirements in situations where a business has been profitable for 3-5 years and not defaulted on repayments in the past. Another suggestion was that NMB should allow loans to be refinanced.

**Figure 14: Impact of COVID-19 on the mid-sized corporate borrowers**



Both hotels had to temporarily shut down at the peak of the pandemic. Consequently, their revenues fell drastically, which affected their ability to pay expenses, particularly salaries. As a result, the hotels had to make some of their employees redundant during the pandemic.

To cope with the effects of the pandemic hotel 1 took an NPR loan from NMB to manage its operations and pay expenses during the crisis. Hotel 2 liquidated assets from its other businesses to finance its spending. As such, both hotels were able to retain most of their employees during the pandemic. Additionally, both hotels sought funding from NMB to reduce the burden associated with their loan repayment obligations, including servicing interest payments on the USD loans they had received from NMB.

In line with NRB's directive, NMB provided hotel 1 with a moratorium on both interest and principal payments for two years during the pandemic. For hotel 2, NMB halted repayments of the principal amount for a period of two years, but the hotel was still required to continue making interest payments on its dollar loan.

**Table 4:** Lessons learned on the impact of BII's investment on NMB's borrowers

**QUESTION 2:** Was NMB successful in reaching and serving MSMEs and what types of MSMEs have been reached?

**Lesson 2.2:** When selecting investees, several key factors should be taken into consideration, including good customer service, a strong reputation, and a relatively sizable physical and technological presence

Customer service, a strong reputation, and a relatively sizable physical and technological presence play a crucial role in attracting new borrowers, especially when there is an existing pool of satisfied borrowers who can vouch for the provider. Additionally, the capacity and strategic placement of a bank's physical and technological infrastructure in comparison to its competitors are important considerations.

In an era of increasing digitalisation and branch rationalisation, in making investment decisions DFIs should pay heed to the investee's physical and technological infrastructure relative to other players in the market, as well as the investee's ability and willingness to expand its services to reach underserved segments.

**QUESTION 3:** How have NMB's financial offerings impacted their MSME and mid-sized corporate borrowers?

**Lesson 3.1:** While financing plays a crucial role, borrowers highly value additional forms of support beyond financial assistance

It is important that DFIs consider supplementing financial services with non-financial support, as solely providing funding may not yield optimal results. Assisting MSMEs in preparing required financial statements and project budgets can greatly enhance their prospects of obtaining loans, thus contributing to loan growth.

Non-financial support played a significant role in helping NMB to effectively expand its MSME portfolio.

**QUESTION 4:** How were MSMEs and mid-sized corporates impacted by COVID-19 crisis and what strategies worked to ensure business sustainability (for NMB and their customers)?

**Lesson 4.1:** Disparities in access to finance between MSMEs and mid-size corporates resulted in greater impact on the solvency and profitability of MSMEs than on mid-size corporations during the COVID-19 pandemic

During the pandemic it became evident that local, smaller businesses required greater support than larger businesses. Unlike their larger counterparts, small businesses often lack alternative financing options. As a result, they are more vulnerable to financial strains and are likely to resort to liquidity support through bank lending.

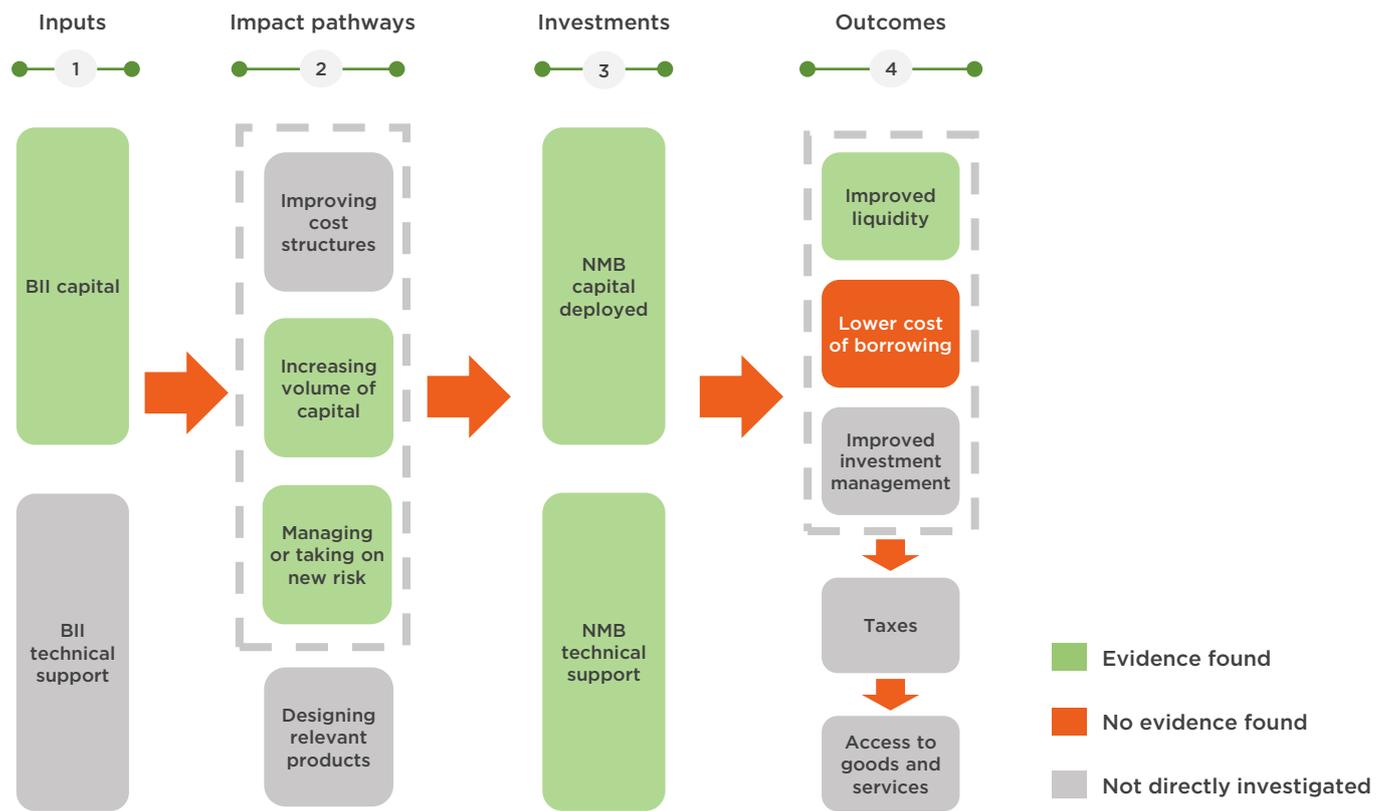
To prevent business disruption caused by short-term financial pressures and avert economic disruptions during times of strain or crisis, there is a strong rationale for DFIs to prioritize directing financial support towards smaller businesses.

## 2.3 Impact mapped to FI-DI framework

Under its 2017-2021 strategy, BII has produced development impact frameworks for each of its key investment sectors, including financial services. BII developed these frameworks as a consistent way to articulate impact, and to provide a lens to assess expected impact, and monitor it over time.<sup>75</sup>

We used BII's FI-DI impact framework, and retrospectively mapped findings from the study onto this framework. This is shown in the figure below. Areas where we identified strong evidence of impact are highlighted in green, while areas highlighted in grey are areas where we found no or inconclusive evidence.

**Figure 15: Findings of the evaluation mapped to FI-DI framework**



Source: BII, 2021

75 British International Investment. (2023). What impact means to us.

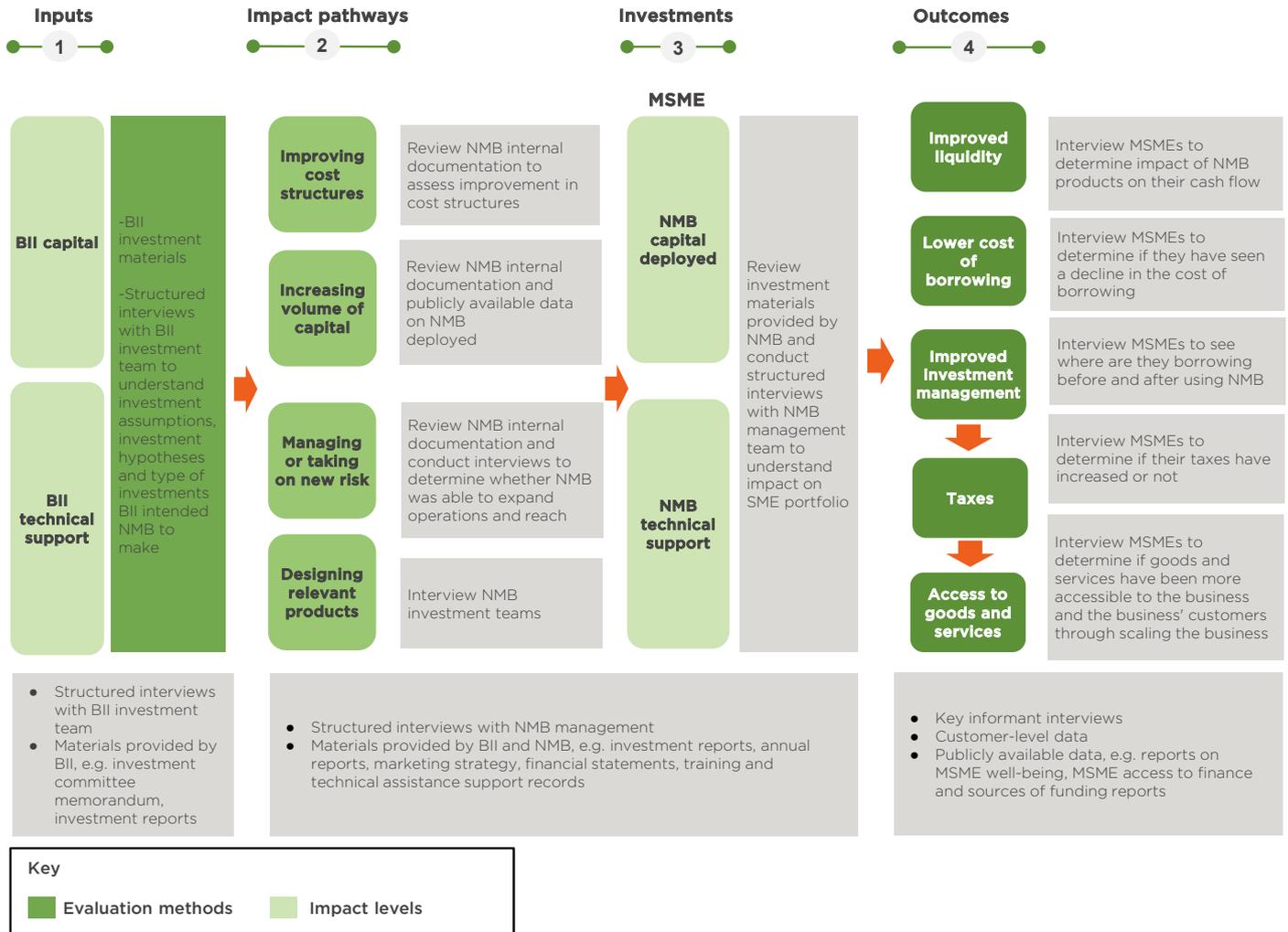
The table below summarizes the evaluation findings in comparison to the FI-DI framework, with summary findings provided for each impact level.

**Table 5: Summary of Evaluation Findings**

Impact level	Summary of Evaluation Findings
1	<ul style="list-style-type: none"> <li>• BII provided capital in the form of a \$15 million unsecured loan to NMB in a liquidity-constrained market.</li> </ul>
2	<ul style="list-style-type: none"> <li>• BII's investment increased the volume of capital available to NMB, thereby enabling the bank to increase the number and value of loans disbursed to MSMEs by 22 per cent and 23 per cent, respectively.</li> <li>• BII's investment enabled NMB to extend USD loans to the tourism sector. Forty-eight per cent of the \$15 million loan was disbursed to two Hotels.</li> </ul>
3	<ul style="list-style-type: none"> <li>• NMB mainly provided capital in the form of local currency loans to MSMEs and USD loans to two Hotels.</li> <li>• NMB provided technical support in the form of financial business assistance to MSMEs and one of the Hotels. This support was delivered informally based on the businesses' relationship with their account manager at the bank.</li> </ul>
4	<ul style="list-style-type: none"> <li>• By reducing liquidity shortages, BII's investment in NMB allowed the bank to extend its reach to MSMEs and two Hotels.</li> <li>• BII's investment in NMB was instrumental to the bank despite the risks associated with taking on foreign currency risk, although the dollar loan was relatively small compared to NMB's balance sheet.</li> <li>• NMB was able to reach MSMEs, particularly those in rural areas, due to the bank's scale, customer services, and physical presence across all of Nepal's provinces.</li> <li>• As a result of NMB's loans, 91 per cent of the interviewed MSMEs and both Hotels stated that they experienced business expansion, although the majority of the positive impact was experienced prior to the COVID-19 pandemic.</li> </ul>

# Annex 1: BII's FI-DI impact framework

Figure 16: Methodological framework based on BII's FI-DI Impact Framework





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