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Factors Influencing Loan Repayment Among the Customers of Microfinance Institutions in Pokhara, Nepal

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Abstract

Background: Understanding the factors influencing loan repayment is essential for ensuring borrowers make timely loan payments. The microfinance model allows borrowers to access small business loans safely, aligned with ethical lending standards. Moreover, repayment behaviour highlights how individuals manage their debt, whether through on-time payments, paying more than the minimum, or defaulting.

Objectives: This paper examines the factors influencing loan repayment among microfinance customers in Pokhara. Client, business, lender, and group characteristics are potential influencers of loan repayment.

Methods: The study is based on a survey method with a purposive sampling technique, focusing on 120 respondents from registered microfinance institutions in Pokhara. Data was gathered using structured questionnaires, and the analysis was conducted using descriptive and inferential statistics.

Results: The findings reveal that client characteristics such as age, marital status, and education significantly affect loan repayment, with middle-aged, married individuals showing better repayment behaviours. Business characteristics positively influence repayment, including enterprise type, years in operation, and business size. Lender characteristics such as MFI policies, monitoring, and performance are crucial in enhancing repayment, while group characteristics like peer support and pressure do not significantly impact repayment behaviour.

Conclusion: The age, education, business type, and size of a client play a significant role, while lender policies and monitoring are also crucial. In contrast, group dynamics have less impact. Thus, microfinance institutions may focus on developing tailored financial products, flexible repayment schedules, and supportive programs to help clients repay their loans effectively.

Keywords: Business characteristics, client characteristics, lender characteristics, loan repayment, microfinance institutions

Paper Type: Research Paper

JEL Classification: E4, E5, G21, G28

Introduction

Microfinance offers small-scale financial services, such as credit, savings, and insurance, to low-income individuals engaged in farming, fishing, and small enterprises in developing countries (Robinson, 1998). These services empower impoverished households and microenterprises by promoting financial inclusion and creating income-generating opportunities, particularly for marginalised groups like women, people with disabilities, and Dalits (Asian Development Bank [ADB], 2011; Shrestha, 2007). Microfinance institutions (MFIs) specialise in providing these services to low-income clients, aiming to foster self-employment and economic development while addressing the financial needs of those typically excluded from traditional banking (Nepal Rastra Bank, 2013; Dhungana, 2013; Mokhtar, Gilbert, & Christopher, 2012).

The modern microfinance movement gained recognition in 1976 when Muhammad Yunus initiated a rural credit project in Bangladesh, leading to the establishment of the Grameen Bank, a global model for MFIs (Yunus, 1983). South Asia, primarily India and Bangladesh, is a hub of microfinance movement in outreach and innovation (Mia et al., 2019). Likewise, Southeast Asia also experienced significant growth, especially in countries such as Cambodia and Indonesia (Donaghue, 2004). Microfinance is a tool for expanding financial services to the unbanked population across sub-Saharan Africa. In Kenya, microfinance integration has been advanced with new mobile banking products such as M-Pesa (Siano et al., 2020). The world-leading microfinance institutions in Asia and Latin America have supported the building of substantial and sustainable microfinance industries (Donaghue, 2004).

In Nepal, formal microfinance began with credit cooperatives in the 1950s and was officially recognised as a poverty alleviation strategy during the Sixth National Plan (1980-1985), contributing to the growth of MFIs serving lower-income populations (Armendáriz & Gollier, 2000). While microfinance aims to serve those excluded from traditional banking, MFIs face challenges such as loan defaults, which can threaten their sustainability, as high repayment rates are crucial for confirming that their services meet clients' needs (Ledgerwood, 1999; Godquin, 2004). Loan repayment involves borrowers returning borrowed funds, typically with interest, within a specified timeframe, and those who comply positively impact the success of microfinance initiatives (Pindback, 1981).

MFIs are critical in extending financial services to underserved populations, reducing poverty, and promoting economic empowerment. However, sustaining the operations of these MFIs heavily relies on the repayment rates of loans disbursed to their customers. Despite the importance of loan repayment for the financial sustainability and effectiveness of MFIs, achieving and maintaining high repayment rates poses significant challenges in the context of Pokhara. This study has attempted to examine the factors influencing loan repayment of microfinance in Pokhara.

Most of the studies are related to socioeconomic transformation and other issues related to microfinance. There is limited study on the factors affecting loan repayment, and it has not covered the influencing client characteristics, business characteristics, lender characteristics, and group characteristics in the Nepalese context. This study has focused on the loan repayment behaviour of clients in the microfinance industry. Delinquency management and repayment issues are significant in the microfinance sector and may affect sustainability and viability in the long run. The findings of this study are expected to contribute to microfinance institutions and policymakers to improve repayment performance and the quality of the loan portfolio.

Review of Literature

Microfinance provides small-scale financial services, such as loans, savings, and insurance, to low-income individuals who typically lack access to traditional banking systems. It encompasses a broader range of services than microcredit, focusing primarily on loans, including other financial products like savings and insurance. The primary objective of microfinance is to enable individuals

from economically disadvantaged backgrounds to generate income through self-employment, thus improving their financial independence and living standards (Sharma & Zeller, 1997; Khandker, 1998).

Microcredit, a key aspect of microfinance, provides small loans to people experiencing poverty for self-employment activities. These loans, typically with short repayment terms and higher interest rates, are geared towards income-generating activities such as agriculture or small-scale trade. In addition to financial services, microcredit programs often offer savings options, training, and peer support to help borrowers achieve and sustain their business ventures (Chapagain & Dhungana, 2020; Jaffer, 1999). Microcredit thus serves as a tool for providing financial aid and empowering individuals to maintain their livelihoods (Dhungana et al., 2023; Schreiner & Colombet, 2001).

MFIs have evolved from non-governmental organisations (NGOs) into formal entities governed by regulations to ensure proper management and service delivery to underserved populations. These institutions aim to alleviate poverty at the individual level and establish a sustainable financial framework for the economically marginalised. The sustainability of MFIs relies on responsible pricing, client transparency, over-indebtedness prevention, and the fair treatment of borrowers. These factors are critical for maintaining operational and financial viability (Lamichhane, 2021; Otero, 1999; Sharma, 2011).

Angaine and Waari (2014) found that various characteristics of clients, businesses, and lenders significantly impact loan repayment. Their research indicated that borrowers with more dependents tend to experience repayment delays, while educational attainment plays a crucial role in repayment performance. Similarly, Makorere (2014) identified factors such as interest rates and economic stability that influence repayment behaviour in Tanzania, underscoring the necessity for government involvement and enhanced credit risk management by financial institutions. Furthermore, Folefack and Teguia (2016) discovered in Cameroon that household size, profitability, and credit management training are essential for timely repayments, while demographic factors like age and gender had limited effects.

Mirpourian et al. (2016) highlighted the importance of borrower motivation in India, where the aspiration for larger loans positively correlated with repayment rates. Meanwhile, Yogendrarajah and Semasinghe (2016) noted that while household decision-making exerted minimal influence on repayment, asset control had a negative impact, suggesting that empowering women in decision-making could enhance repayment rates. Giri and Shah (2019) argued that the characteristics of lenders and businesses have a more substantial effect on loan repayment compared to borrower traits, advocating for supportive policies for borrowers. Sangwan et al. (2020) also identified that increased financial literacy and social cohesion contributed to lower loan delinquency rates.

In Sri Lanka, Wickramasinghe (2020) found that borrower, business, and loan characteristics are significant determinants of microfinance loan repayment. Abimbola (2021) observed that socioeconomic factors, including age and education levels, significantly influenced loan repayment rates in Nigerian Microfinance Banks, recommending lower interest rates and more extended repayment periods. In Ethiopia, Adugna (2022) pinpointed critical factors affecting loan repayment, such as education and borrower training. Other studies, such as those by Edris (2022) and Ally et al. (2023), revealed that financial literacy, supervision, and economic stability are crucial for improving repayment among borrowers. These studies illustrate the complex interplay of borrower characteristics, lender policies, and economic conditions in enhancing loan repayment rates.

In the Nepali context, Shrestha and Koirala (2022) emphasised the role of financial literacy and borrower education in improving repayment rates, suggesting that those with higher education levels are more likely to manage loans effectively. Similarly, Bhandari et al. (2021) found that household income and economic stability directly affect loan repayment performance, as clients with more stable incomes are less prone to default. Pandey (2023) highlighted the significance of proper credit

management training provided by microfinance institutions, which enhances clients' repayment behaviour. Furthermore**,** Gautam and Thapa (2023) underscored that socioeconomic factors, such as household size and employment status, play a critical role in determining loan repayment capacity, with larger households facing more difficulties in timely repayments. These findings indicate that financial education, credit management, and socioeconomic conditions are key determinants of loan repayment in Nepal's microfinance sector.

Research Methods

Conceptual Framework

Based on a literature review, important factors such as client, business, lender, and group characteristics have been identified as potential influencers of loan repayment.

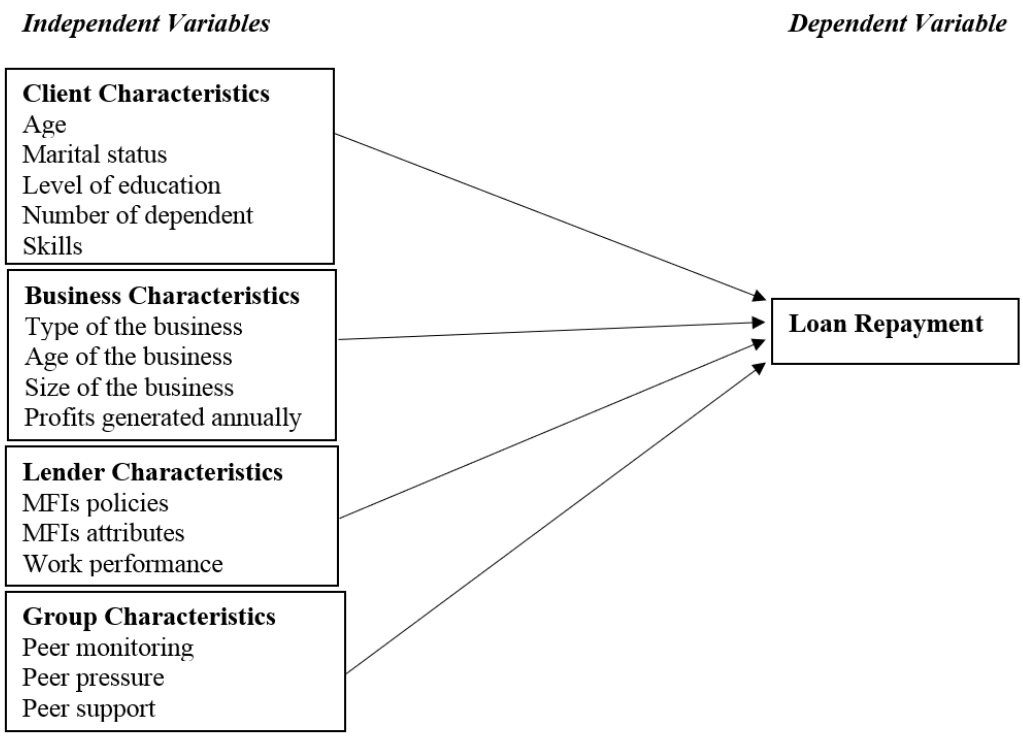

Figure 1 The conceptual framework of the study

Source: Based on a literature review made by researchers.

Based on the above conceptual framework, the following hypotheses have been developed:

H_1: Client characteristics have a significant influence on loan repayment among microfinance loan beneficiaries in Pokhara.

H_2: Business characteristics have a significant impact on loan repayment among microfinance loan beneficiaries in Pokhara.

H_3: Lenders' characteristics have a significant effect on loan repayment among microfinance loan beneficiaries in Pokhara.

H_4: Group characteristics have a significant response on loan repayment among microfinance loan beneficiaries in Pokhara.

Study Area, Population and Sample Size

This research is limited to the Pokhara Metropolis in the Kaski District of Nepal due to the significant presence of microfinance institutions in this region. The participants have been engaged in microfinance for at least three years and operate their microenterprises. The study included around 5.45% of the MFIs in Pokhara, resulting in a total sample of 120 respondents. The MFIs in Pokhara Metropolitan were selected which have adopted the Grameen Model, naming Grameen Bikas Laghubitta Bittiya Sanstha Limited, Jalpa Samudayik Laghubitta Bittiya Sanstha Limited and Chhimek Laghubitta Bittiya Sanstha Limited. To ensure a diverse borrower of three MFIs, a quota sampling method was employed to select 40 respondents from each MFI, ensuring a representative sample while reducing the likelihood of bias.

Data Collection Techniques

Primary data was collected using structured questionnaires distributed to clients involved in microfinance for three or more years. The study follows a descriptive and explanatory research design, with data analysed using SPSS software. A pilot test was conducted with ten respondents to refine the questionnaire and maintain the validity of the research. The Cronbach's Alpha values for the business characteristics, lender's characteristics, group characteristics, and loan repayment behaviour are 0.720, 0.624, 0.741, 0.682, and 0.713, respectively. These values suggest that most of the constructs have acceptable reliability, with lender's characteristics showing the highest reliability at 0.741 and business characteristics the lowest at 0.624.

Data Analysis and Results

Descriptive Statistics

Demographic Profile of Respondents

The demographic profile of respondents includes age group, marital status, academic level, monthly family income and number of dependents in the family. Table 1 shows the demographic profile of the respondents.

Table 1 Demographic Characteristics of Respondents

Respondents' Detail	Number of Response	Percentage
Age Group		
Below 25 years	5	4.2
25 to 35 years	17	14.2
36 to 45 years	40	33.3
46 to 55 years	34	28.3
Above 55 years	24	20.0
Marital Status		
Divorced	2	1.7

Married	111	92.5
Widow	7	5.8
Academic Level		
Illiterate	3	2.5
Literate	41	34.2
Primary (1-8)	52	43.3
Secondary (9-12)	22	18.3
Above Secondary Level	2	1.7
Monthly Family Income (NRs.)		
Below Rs 20,000	19	15.8
Rs 20,000 to Rs 35,000	38	31.7
Rs 35,001 to Rs 50,000	37	30.8
More than Rs 50,000	26	21.7
Number of Dependents in Family		
1 to 2	72	60.0
3 to 4	36	30.0
5 to 6	10	8.3
More than 6	2	1.7
Total	120	100.0

Source: Calculation based on the survey, 2024.

Table 1 summarises the demographic characteristics of 120 microfinance clients in Pokhara. Most respondents are middle-aged, with 33.3% aged 36 to 45 and 28.3% aged 46 to 55. Most (92.5%) are married. Regarding education, 43.3% have completed primary education, and 34.2% are literate without formal education. Monthly family incomes mainly fall between Rs 20,000 to Rs 50,000 (62.5%), and the majority (60%) have 1 to 2 dependents.

Table 2 Type of Micro Enterprise

Types of Enterprises	Frequency	Percentage
Agriculture/ Farming	35	29.2
Business	68	56.7
Services	17	14.2

Total	120	100.0

Source: Field Survey, 2024.

Table 2 summarises the frequency and percentage analysis of enterprises operated by respondents in Pokhara. It shows that 56.7% of participants are engaged in businesses other than agriculture or farming, highlighting a diverse range of ventures in the area. Agriculture or farming accounts for 29.2%, while 14.2% are involved in service-oriented enterprises. The total sample size for this analysis is 120, with each category representing a proportional share of the respondents.

Table 3 Duration of Business

Duration of Business	Frequency	Percentage
3- 5 years	26	21.7
6-10 years	50	41.7
More than 10 years	44	36.7
Total	120	100.0

Source: Field Survey, 2024.

Table 3 presents the frequency and percentage analysis of the operational duration of microbusinesses in Pokhara. The findings indicate that 41.7% of respondents have been in business for 6-10 years, reflecting a strong presence of established enterprises. Additionally, 36.7% have been operating for over 10 years, highlighting the longevity of many microbusinesses in the region. In contrast, 21.7% of respondents have operated for 3-5 years, showcasing a smaller segment of relatively newer businesses.

Table 4 Size of the Business

Number of Employees	Frequency	Percentage
1	98	81.7
2 to 5	21	17.5
6 to 9	1	.8
Total	120	100.0

Source: Field Survey, 2024.

Table 4 presents the frequency and percentage analysis of employees in microbusinesses in Pokhara. The study reveals that 81.7% of microbusinesses are self-employed, with only one employee, highlighting the prevalence of small-scale entrepreneurship in the region. Additionally, 17.5% have between 2 to 5 employees, indicating a modest presence of slightly larger enterprises, while only 0.8% employ 6 to 9 individuals.

Table 5 Annual Business Income

Annual Business Income	Frequency	Percentage
Less than Rs 1,20,000	26	21.7
Rs 1,20,000 to 2,40,000	43	35.8
Rs 2,40,001 to 3,60,000	39	32.5
More than Rs 3,60,000	12	10.0
Total	120	100.0

Source: Field Survey, 2024.

Table 5 presents the frequency and percentage analysis of annual business income for microbusinesses in Pokhara. The data shows that 35.8% of respondents generate an annual income between Rs 1,20,000 and Rs 2,40,000, indicating a notable concentration of microbusinesses within this income range. Additionally, 32.5% earn between Rs 2,40,001 and Rs 3,60,000, representing another significant segment with higher earnings. Meanwhile, 21.7% of respondents earn less than Rs 1,20,000 annually, reflecting the existence of microbusinesses at the lower end of the income spectrum—only 10.0% report annual earnings exceeding Rs 3,60,000.

Inferential Analysis

Table 6 Pearson Correlation Analysis Between Variables of Microfinance Loans

Variables	CC	BC	LC	GC	LRP
CC	1				
BC	.230*	1			
	.011				
LC	.104	.206*	1		
	.257	.024			
GC	-.030	.125	.311**	1	
	.746	.175	.001		
LRP	.476**	.493**	.305**	.115	1
	.000	.000	.001	.211	

*. Correlation is significant at the 0.05 level (2-tailed).

**. Correlation is significant at the 0.01 level (2-tailed).

Source: Field survey and calculation, 2024.

The Pearson correlation analysis reveals significant positive relationships between loan repayment (LRP) and client characteristics (CC), financial business characteristics (BC), and lender characteristics (LC). Client characteristics (CC) show a moderate positive correlation with LRP (r = 0.476), indicating that factors like education, skills, and dependents influence repayment behaviour. Business characteristics (BC) also have a positive correlation (r = 0.493), suggesting that business type, size, and profitability

play a role in efficient repayments. Lender characteristics (LC) show a weaker but significant positive correlation (r = 0.305), highlighting the importance of effective loan management and communication. However, group characteristics (GC) do not significantly impact repayment behaviour. These findings emphasise the role of client, business, and lender factors in improving loan repayment performance.

Table 7 Regression Model

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.646[a]	.417	.396	.44216

Predictors: (Constant), GC_AVG, CC_AVG, BC_AVG, LC_AVG

Source: Field survey and calculation, 2024

The regression model shows a strong positive correlation (R = 0.646) between the independent variables—client characteristics, business characteristics, lender characteristics, and group characteristics—and loan repayment. With an R Square of 0.417, the model explains 41.7% of the variance in loan repayment, while the Adjusted R Square (0.396) confirms the model's robustness. A low standard error of 0.44216 indicates precise predictions.

Table 8 ANOVA of Variables in Regression Model

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	16.067	4	4.017	20.545	.000[b]
Residual	22.483	115	.196		
Total	38.550	119			

a. Dependent Variable: LRP_AVG

b. Predictors: (Constant), GC_AVG, CC_AVG, BC_AVG, LC_AVG

Source: Field survey and calculation, 2024.

The ANOVA table confirms the overall significance of the regression model in predicting loan repayment. With an F-value of 20.545 and a significance level 0.000, the model is statistically significant at the 1% level. This indicates that the independent variables—client, business, lender, and group characteristics—collectively impact loan repayment. These results validate the model's effectiveness and relevance in understanding loan repayment behaviour in microfinance settings.

Table 9 Regression Coefficients of Loan Entities on Loan Repayment

		Unstandardised Coefficients		Standardised Coefficients			Collinearity Statistics	
Model		B	Std. Error	Beta	**T**	**Sig.**	Tolerance	VIF
1	(Constant)	.759	.389		1.950	.054		
	CC	.354	.070	.373	5.077	.000	.937	1.067
	BC	.386	.079	.366	4.899	.000	.907	1.102
	LC	.150	.062	.183	2.395	.018	.869	1.150
	GC	.021	.067	.024	.314	.754	.894	1.119

Source: Field survey and calculation, 2024.

The regression coefficients table highlights the significant impact of client characteristics (CC), business characteristics (BC), and lender characteristics (LC) on loan repayment (LRP). Client characteristics (CC) have a strong positive effect, with a high unstandardised coefficient (B = 0.354) and significant t-value (5.077, p = 0.000), as reflected by a standardised coefficient (Beta = 0.373). Business characteristics (BC) also have a significant favourable influence, with an unstandardised coefficient of 0.386 and a Beta of 0.366. Lender characteristics (LC) show a moderate positive impact, with a Beta of 0.183, while group characteristics (GC) have a negligible, non-significant effect on loan repayment (Beta = 0.024). Low collinearity among the predictors (high tolerance values and low VIF) confirms that these factors independently contribute to explaining loan repayment.

Discussion

This study highlights the essential factors influencing loan repayment behaviour among microfinance clients in Pokhara, explicitly examining how client, business, and lender characteristics impact repayment. The results indicate that middle-aged clients with higher education levels and more significant numbers of dependents are more likely to repay their loans effectively, aligning with previous research by Angaine and Waari (2014) and Abimbola (2021). In contrast to the findings of Folefack and Teguia (2016) in Cameroon, which noted minimal effects of age and gender, this study identified age as a significant factor, potentially reflecting cultural and economic differences between Nepal and Cameroon.

Business characteristics, including the nature of the business, years in operation, profitability, and training, were found to be vital for loan repayment, supporting the conclusions of Wickramasinghe (2020), Adugna (2022), and Makorere (2014). Giri and Shah (2019) similarly pointed out that business-related factors tend to exert a more significant influence on repayment than borrower characteristics, although this contrasts with Sangwan et al. (2020), who emphasised the importance of household characteristics. Microcredit helps engage clients in productive sectors such as microbusinesses and microenterprises (Ranabhat & Dhungana, 2021). Additionally, lender practices positively affected repayment, corroborating Giri and Shah's (2019) assertion that enhancements in microfinance institution policies can improve loan performance. However, the study noted that group characteristics, such as peer influence, had a negligible impact on repayment behaviour, which contradicts the findings of Mirpourian et al. (2016) and Nerash et al. (2023). This suggests that group dynamics may hold less significance in Pokhara's microfinance environment. The regression analysis revealed that client, business, and lender characteristics explained 41.7% of the variance in loan repayment, consistent with results from other studies (Abimbola, 2021; Mohammed & Wobe, 2023). The research underscores the need to enhance client education, foster business development, and improve lender practices to promote better loan repayment behaviour in Pokhara.

Conclusion and Recommendations

This study examined the factors influencing loan repayment behaviour among microfinance clients in Pokhara, Nepal, focusing on client, business, lender and group characteristics. It revealed that client attributes such as age, marital status, education level, and skills significantly impact repayment, particularly for middle-aged, educated, and skilled clients. Business characteristics, including type of enterprise, experience, and income, also play a vital role. While lender practices positively affect repayment, group dynamics showed minimal influence. The quality of loan portfolios and repayment is a significant concern for MFIs due to the collateral-free lending system. Client, business, and lender characteristics are significant factors in microfinance institutions' loan repayment. As a result, MFIs may empower MF clients to operate microbusinesses and enterprises sustainably, and finally, the repayment rate can be increased.

Based on such findings, recommendations include flexible repayment plans for low-income clients,

financial literacy programs fitted for middle-aged married people, and extended business support services in the form of mentoring and training. MFIs may develop loan products that match businesses' diverse types and sizes. More income-generating initiatives may be implemented with personalised support instead of a group-based approach to respond more specifically to clients' needs. The study is limited to borrowers from selected MFIs in Pokhara. Metropolis that have been engaged for three years or more and own businesses in this region may not fully represent the broader microfinance landscape of the country.

Additional Information and Declaration

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