Determinants Factors of Microfinance Performance in Nepal

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ABSTRACT

This study concerns the key factors of performance of the Nepalese microfinance institutions (MFIs). The principal goal of the study is the identification of necessary operational performance of MFIs. The determinants influencing MFIs' performance were identified using descriptive, correlational, and casual-comparative study methodologies. The study's conclusions demonstrated a strong correlation between MFIs performance and information technology, loan lending processes, and regulatory environment. The regulatory Framework seems to be an important factor in Nepal's microfinance performance as well. The study also discovered that MFIs performance is significantly influenced by the loan lending system, regulatory environment, and information technology. The study discovered that the loan lending system, regulatory framework, information technology, loan lending system, employee motivation, management system, effective risk management, and regulatory framework have a positive link with the performance of MFIs and significantly affect it. Additionally, it shows that the operational effectiveness of MFIs in Nepal has no correlation with employee motivation, management system, and effective risk management. The study's findings will be helpful to all parties involved with MFIs, including investors, regulators, legislators, and BFIs. According to the outcome, operational efficiency significantly affects the viability and continuation of service of Nepalese MFIs.

1. INTRODUCTION

A financial system and powerful instrument that helps the underprivileged lift themselves out of poverty is microfinance. Different individuals and institutions have given different definitions of microfinance. Microfinance is the provision of a range of financial services to low-income individuals, households, and their small businesses, including deposits, loans, payment

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services, money transfers, and insurance (Ledgerwood, 1999). Microfinance is the provision of a wide range of financial services to low-income households and their microbusinesses, including deposits, loans, payment services, money transfers, and insurance. The goal of microfinance's founders was to provide formal financial services to the underprivileged, who were turned away by banks due to their modest resources, low credit demand, and lack of loan collateral. (Armendariz, 2011).

MFIs engage in micro banking with the underbanked -those at the base of the pyramid, whom traditional banking institutions typically view as unbankable. Their portfolio is primarily made up of unsecured group loans. In a group meeting, they lend to and collect from members. The field operations of MFIs were hampered by lockdown procedures and the ban on public gatherings due to concerns about disease transmission. In addition, the suspension of most economic operations, with the exception of a few crucial firms, hurt MFI borrower income and hampered loan repayment. Despite the fact that Covid-19 affects practically all countries, each country may experience a different impact, and different sectors within one country may experience varying burdens. As a result, it is necessary to carefully examine the degree of influence on various industries from various angles. Covid-19 has had a significant negative impact on practically every sector of the economy, but low-income people and small companies are disproportionately affected because they have few assets or savings to help them weather the shock of the present pandemic (Shrestha, 2020).

The concept of organizational success for MFIs has changed as a result of the evolving microfinance sector. Along with social goals including eradicating poverty, empowering women, and ensuring the disadvantaged have access to financial resources (Ledgerwood, 2013). MFIs must maintain strong financial ratios (financial performance) in order to thrive in an environment of growing market competition (Gutierrez, 2010). As a result, many MFIs adopt a double-bottom line strategy, albeit with some variations in their relative emphasis. While for-profit MFIs primarily focus on achieving clearly defined financial goals, non-profit MFIs typically place more importance on their social performance (Mersland, 2009). Additionally, for both types of MFI, the competitive environment has resulted in a stress on efficiency as a component of organizational success (Hermes, 2011).

Academics, politicians, knowledge seekers, and development professionals pay close attention to today's microfinance organizations. Academics and professionals can both learn from this review. Our contribution, in particular, offers a thorough framework for studying MFIs from a management perspective, laying the groundwork for future expansion of management-relevant knowledge about MFIs. This study focuses on the various trends that affect how well the MFIs in Nepal perform. This study's main goal is to examine the variables that affect Nepal's microfinance industry performance. Analysis of the determinants of Nepalese MFI performance, as well as an examination of the function of information technology, loan lending systems, motivated staff, risk management, management system regulatory framework, and their impact on MFIs performance, are the specific goals of this study.

2. LITERATURE REVIEW

This section includes a conceptual assessment of the study's subject and adjacent fields as well as a review of earlier investigations. Reviewing the literature is looking into earlier studies or other pertinent arguments in the relevant field of study so that all earlier studies, their findings, and perspective gaps can be identified and additional research can be carried out. It is crucial for all research to transmit the body of information and theories that have been developed on a subject in the past, together with their advantages and disadvantages.

2.1 Threotical Review

2.1.1 Corporate Governance Theory

Corporate governance practice plays a significant role in the operation of microfinance institutions for enhancing financial performance and also needs a considerable member of women, a moderate board size, diverse expertise and skills, separation of power and authority board chairman and CEO positions, and good governance structure positively influenced the financial sustainability of MFIs (Chenuos et al., 2014). There is a substantial relationship between corporate governance and the performance of MFIs. Governance provides guidance for a way out of the good governance dimension of microfinance institutions board diversity (that is, gender, profession, and ethnicity), board size, independent board, differentiating of power on CEO and chairman, internal and external audit, internal control mechanism, corporate mission, and regulatory environment, which influence both the financial performance and outreach (Thrikawala, 2013).

2.1.2 Portfolio Management Theory and Adverse Selection Theory

The idea of adverse selection, the theory of portfolio management, and the theory of information asymmetry served as the foundation for this essay. The portfolio management theory of adverse selection was created by (Stringlitz, 1981). Theoretically, customers/borrowers of credit providers/banking and financial institutions (BFIs) have unique qualities and traits that are neither observable nor quantifiable by banks and MFIs while lending, which has an immediate impact on revenue and profitability. According to the argument, lenders are unable to accurately discern between bankable consumers and other hazards. The unfavourable selection theory explains how banks that are unable to distinguish between safer and riskier clients end themselves in this scenario. According to this view, banks act as the lenders, while MFIs lack sufficient client data. According to a risk evaluation system, BFIs would charge higher interest rates for riskier clients and lower interest rates for safer ones.

By examining past credit history, collateral, financial features, and private information about local credit applicants, the theory has focused on reviewing their clients to distinguish between creditworthy and non-creditworthy borrowers (Lamichhane, 2022).

2.2 Empirical Review

The literature has shown that a variety of factors, including management, leadership, staff training, employee motivation, information technology, product or service innovation, loan lending system, governmental regulatory framework, financial risk management, marketing, corporate governance, and auditing system, are necessary for microfinance institutions to succeed (Al Mamun, 2012).

The loan lending system, employee motivation, a suitable management structure, effective risk management methods, and the regulatory framework established by the government, according to (Akhter, 2018) all have a substantial impact on the success of MFIs. It also demonstrates how little impact innovation and information technology (IT) have on the efficiency of Bangladesh's microfinance banks. It indicates how effective risk management has a negative link with MFI performance, but that positive relationships exist between MFI performance and the loan lending system, employee motivation, competent management, and governmental regulatory framework.

Microfinance is defined as financial services provided to underserved groups of people and small business owners in the areas of saving, credit, remittance, and rural insurance to assist them in creating opportunities for self-employment and other forms of income generation. Microfinance institutions engage in income-generating activities to advance the interests of the underprivileged by offering essential services and helping to raise their economic and social standards (NRB, 2007). The best strategy for the operational and financial sustainability of microfinance institutions includes product design and delivery, over-indebtedness prevention, transparency, responsible pricing, fair and respectful treatment of clients, the privacy of client data, and mechanisms for complaint resolution (Lamichhane, 2021). Among development initiatives, microfinance is exceptional since it may provide a variety of social benefits on an ongoing, permanent, and widespread basis (Sharma, 2011). Reduced MFI delinquency can be achieved through the following factors: good governance in loan delivery processes, client identification, effective credit appraisal, and review of client credit history; professional client knowledge; client literacy; and identification of clients' over-indebtedness; credit monitoring and controls; and loan utilization (Lamichhane, 2022).

2.2.1 Information Technology (IT)

Performance of MFIs is significantly impacted by innovation in goods or services and information technology systems (Leonard, 2016; Irene, 2013; Al Mamun, 2012; Hassan, 2002). In order to satisfy customer requests, MFIs always offer new goods. They provide various loans, including those for farmers, seasonal businesses, and entrepreneurs, among many other voluntary endeavours. The MFIs are using information technology to both keep track of routine tasks and capture various forms of client information.

2.2.2 Loan Lending System

Systems for loan lending are necessary for microfinance institutions to advance. Collateral-free lending systems are giving poor individuals the chance to obtain credit via MFIs, which are established as group lending organizations. Systems for group lending are an additional tool for loan repayment. The country's underprivileged are supported financially by microfinance institutions through a special lending mechanism, which also supports the expansion of MFIs (Al Mamun, 2012; Irene, 2013; Hassan, 2002).

2.2.3 Motivation of Employee

The success of the institution depends on qualified personnel who are motivated by tools like employee training and refresher courses, employee incentive programs, and bonus and

promotion programs. These elements contribute to the expansion of MFIs. Staff development is the main strategy for raising staff skill levels in any organization, and it is directly related to institutional advancement in the microfinance industry (Al Mamun, 2012; Leonard, 2016). The expansion of MFIs is a performance-based indicator for the performance-based reward (Hartung, 2007). The most popular method of motivating staff is through bonus and promotion schemes, which have also boosted the success of MFIs (Al Mamun, 2012).

2.2.4 Management System

Any institution's performance depends on management, which is also essential to an organization's sustainability. Both management and leadership are useful strategies for achieving the MFIs' aim. Management is essential for the creation of organizational structure (Tapera, 2016). The innovation and expansion of MFIs are enhanced by good management since it provides a pleasant environment for the workers to become highly devoted, highly focused, and accountable (Ledgerwood, 2006).

2.2.5 Effective Risk Management

Each and every MFI must implement efficient risk identification, measurement, monitoring, and management efforts (Leonard, 2016). Effective risk management is essential for loan client screening and selection, as well as for lowering loan default rates (Kimando, 2012). (Kombo et al., 2011) examined risk management practices used by microfinance organizations and their effects on the sustainability of the institutions' finances. The study aimed to: establish the MFI's preference for the different sources of funding; ascertain the frequency of risk exposure for microfinance institutions; and identify the risk management tactics employed by microfinance institutions in the management of risk exposures and the degree to which they have aided in their financial sustainability. The most prevalent risks are strategic, credit, and liquidity risk, while subsidy dependence and reputational risk are quite rare. The MFIs use a variety of risk management techniques, such as risk avoidance, risk transfer, and risk mitigation, to reduce these risks. The best method of risk management is thought to be risk mitigation. In particular, loan account and loan data reconciliation was thought to be the best risk management strategy for assessing the financial viability of MFIs.

2.2.6 Regulatory Framework

The literature demonstrates that the performance of government rules and regulations affect the expansion of microfinance institutions because a successful regulatory structure fosters an environment that is favorable to MFIs (Woller, 2001). Institutional and national regulation are key to the success of microfinance institutions (Crabb, 2008). The regulatory climate offers a favorable setting for the growth of MFIs (Boating, 2013).

2.3 Conceptual Framework

A conceptual framework with different variations and backgrounds is a logical structure. It is used to differentiate conceptually and to coordinate concepts. Strong logical constructs catch and perform something real that is easy to remember and use. It can function as a map that makes empirical analysis more consistent, since the conceptual structure is so similar to empirical research, which takes various forms, depending on the issue of research or the issue. This section introduces a conceptual framework suited to the context of Nepal and explains the performance of

MFIs in Nepal. The conceptual framework of this study includes the performance of MFIs as a dependent variable. Likewise, independent variables include information technology, a mechanism for lending loans, staff motivation, a management system, good risk management, and a regulatory framework. Based on the above dependent and independent variables, the following concept has been formulated which is given below:

Figure 1

Conceptual Framework of the Study
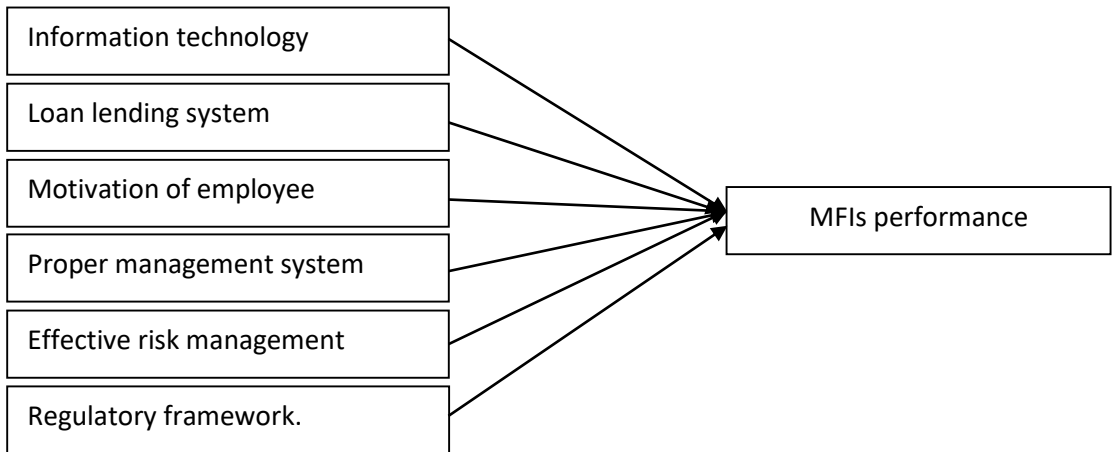
2.4 Research Gap

Fatimah et al. (2012) investigates how the capacity of governmental institutions affects the implementation of microfinance policy by taking into consideration the cases of microfinance regulation in Sri Lanka and Nepal. Many studies have expressed concern about the challenge of MFIs in the world. This study aims to uncover the main characteristics that drive the success of microfinance institutions in Nepal. Similar to this, several studies have focused on how microfinance affects livelihood, health, education, and empowerment as well as its financial, social, and economic effects. Some have concentrated on governance and credit risk management factors, which have a direct impact on loan portfolio quality and service delivery to the poor. They did not pay attention to different aspects of Nepalese MFIs' operational performance. Some studies have concentrated on revenue growth customer satisfaction, internal processes, and employee satisfaction. As a result, operational performance ensures sustainability, viability, productivity, and service continuity but they did not focus on factors affecting the operational performance of MFIs. As a result, this research is critical to the key area of MFIs.

3. METHODOLOGY

For the data collection method, a self-completion questionnaire was employed as this research is based on a survey. Additionally, descriptive statistics, the Cronbach's alpha test, the

correlation and regression tests of sample adequacy and mean value, as well as SPSS software are used in the analysis.

To address the drivers of microfinance performance in Nepal, this study used descriptive and casual comparative research methodologies. The study is based on primary sources of data and the self-administered survey questionnaire was used as the main primary data gathering instrument to assess the opinion of employees regarding information technology, loan lending systems, motivation of employees, management systems, effective risk management, and regulatory framework to find determinants of microfinance performance in Nepal. The personnel of MFIs in Nepal makes up the study's total population. Out of 500 employees, 153 respondents from 10 MFIs in Nepal were taken into account, also used the convenience sampling technique study's analysis of the performance of microfinance in Nepal. The CEO, Deputy CEO, Manager, officer, and operating level workers were the respondents who were targeted. Respondents received the questions through Google Forms. To establish a meaningful relationship between dependent and independent variables, the SPSS program also included tools for correlation and linear regression.

3.1 Model Specification

A model is a condensed mathematical description that is created using the analyst's expertise, prior data, and knowledge of mathematics. The mathematical structure of the model and its parameter count are both necessary for model selection. This section describes how the empirical data was utilized for research to examine Nepal's MFIs' performance in relation to information technology, loan lending systems, employee motivation, management systems, effective risk management, and regulatory framework. To understand the determinants of microfinance performance, the following models are used:

$$MP = \beta_0 + \beta_1\,IT + \beta_2\,LLS + \beta_3\,ME + \beta_4\,MS + \beta_5\,ERM + \beta_6\,RF + \varepsilon_i \ldots\ldots\ldots\ (1)$$

In the above model, the dependent variable is MFIs performance, and independent variables such as IT, LLS, ME, MS, ERM, and RF are tested.
Where,

MP (est.) = Performance of MFIs (MP, representing MFIs Performance) as a dependent variable.

IT = information technology

LLS = Loan lending system

ME = Motivation of employees

MS= Management system

ERM = Effective risk management &

RF = Regulatory Framework as an independent variable.

ε_i is the error term. β_0 is constant and β_1, and β_2, β_3 β_4 β_5, and β_6 are the beta coefficients of the explanatory variables to be estimated.

3.2 Validity and Reliability

A sample that is as representative as possible was obtained in order to ensure external validity. However, the study's sample frame was only open to professionals who were willing to take part. In order to evaluate the validity of the scales, means were also compared. The value

spans from 1 to 6, with 3 being the mean. In general, it is believed that a mean value of 3 or higher denotes an adequate response, a mean value of 3 or less denotes a negative response. The mean value from the pilot survey was 5.11 which helped to coin the test as reliable and move toward the data collected from the population.

Additionally, a factor analysis was conducted to ensure the validity of the scale while a Cronbach's Alpha test was utilized to assess scale reliability. A statistic is Cronbach's Alpha. Cronbach's alpha is the most often used internal consistency reliability measure. A value of greater than or equal to 0.7 is typically regarded as satisfactory and a good sign of construct dependability. The reliability test's outcome is displayed below:

Table 1

Coefficient of Cronbach's Alpha

Variables	No. of questions	Cronbach's alpha
Information technology	5	0.888
Loan lending system	5	0.758
Motivation of employees	5	0.772
Management system	5	0.735
Effective risk management	5	0.871
Regulatory framework	5	0.753
MFIs performance	6	0.814
Overall	36	0.931

Source: Responses on Survey Likert Questionnaire

The reliability test for each question on a questionnaire about the factors influencing MFIs performance in Nepal, which was calculated using SPSS, is shown in Table 1. Cronbach's Alpha of 36 quantitative data is 0.931, which indicates that 93.1% of the data used in the study are valid and 6.9% are incorrect. Data that has a Cronbach's Alpha of better than 0.7 is regarded to be reliable.

4. RESULTS AND FINDINGS

Systematic presentation, interpretations, and analysis of the data received from the questionnaire are covered in this part.

4.1 Correlation Analysis

A vicariate study called correlation assesses how closely two variables are related to one another. A perfectly linear positive or negative relationship exists when the correlation is 1 or -1; when the correlation is 0, there is no relationship between the two variables; a positive association between the two variables arises when the correlation is higher than 0; when the correlation is less than 0, there exists a negative relationship between the two variables.

Table 2

Correlation Analysis

Variables		Performance of MFIs
Information technology	Pearson Correlation	.570
	Sig. (2-tailed)	.000
	N	153
Loan lending system	Pearson Correlation	.437
	Sig. (2-tailed)	.000
	N	153
Motivation of employees	Pearson Correlation	.431
	Sig. (2-tailed)	.000
	N	153
Management system	Pearson Correlation	.336
	Sig. (2-tailed)	.000
	N	153
Effective risk management	Pearson Correlation	.612
	Sig. (2-tailed)	.000
	N	153
Regulatory framework	Pearson Correlation	.646
	Sig. (2-tailed)	.000
	N	153

Table 2 presents the correlation coefficient between the dependent variable and independent variables used in the study. Based on 153 observations, the correlation coefficients were calculated. The performance of MFIs is the dependent variable (Determinants of performance of MFIs in Nepal). Information technology, loan lending systems, staff motivation, management systems, effective risk management, and regulatory framework are the independent variables.

From the above correlation table between various performance determinants factors and the performance of MFIs in Nepal we can see that Information Technology has 0.570, Loan Lending System has 0.437, Motivation of Employees has 0.431, Management System has 0.336, Effective Risk Management has 0.612 and Regulatory Framework has 0.646 correlation value. It indicates that there is a strong positive correlation between all of the six independent variables and the performance of MFIs as dependent variables.

Similarly, the table also shows that all the independent variables i.e. At the 2-tailed significance value, information technology, loan lending system, employee motivation, management system, effective risk management, and regulatory framework are significant as their value is $0.001 < 0.01$ i.e. P value $< \alpha$. Hence there is a favourable relationship with the performance of MFIs. The 0.01 level of significance for correlation (2-tailed). It indicates that if all those independent variables are applied regularly then these variables stimulate the effectiveness in the performance of MFIs.

4.2 Regression Analysis

It is a statistical method for figuring out how different variables relate to one another. The calculated regression results included information technology, loan lending systems, employee motivation, management systems, effective risk management, and regulatory framework as independent factors, with the performance of MFIs as the dependent variable. Regression analysis was utilized in this study to evaluate the hypothesis. This section identifies the independent variables that account for the variability in the outcome, the percentage of the dependent variable's variability that is explained by the independent variables, and the variables that account for the majority of the dependent variable's variability. To determine the relationship between the dependent variable (Performance of MFIs) and the independent variables (information technology, loan lending system, employee motivation, management System, effective risk management, and regulatory framework), linear regression analysis was carried out, because of its ease of use, ease of interpretation, scientific acceptance, and wide availability, linear regression is preferable.

Table 3

Regression Model Summary

R	R^2	Adjusted R^2	Std. error of the estimate
0.784	0.615	0.599	0.34766

a. *Predictors: (Constant), Information technology, loan lending system, motivation of employees, management system, effective risk management, and regulatory framework.*

b. *Dependent Variable: Performance of microfinance.*

In Table 3, it may be concluded that 61.5% of the dependent variable, or the performance of microfinance, is explained by the independent variables information technology, loan lending system, employee motivation, management system, effective risk management, and regulatory framework.

Table 4

Regression ANOVA

Model	Sum of squares	df	Mean square	F	Sig.
Regression	28.177	6	4.696	38.854	0.000
Residual	17.467	146	0.121		
Total	101.712	210			

a. *Predictors: (Constant), Information technology, loan lending system, motivation of employees, management system, effective risk management, and regulatory framework.*

b. *Dependent Variable: Performance of microfinance.*

From the regression ANOVA Table 4, it can be inferred that the independent variables (The relationship between the dependent variable performance of MFIs and the independent variables (information technology, loan lending system, employee motivation, management system, effective risk management, and regulatory framework) is well predicted by these factors, as shown by the significance value 0.000< 0.05.

Table 5

Regression Coefficients

Model	Unstandardized coefficients		Stand coef	T	Sig.	Colinearity statistics	
	B	Std. error	Beta			Tolerance	VIF
(Constant)	.949	.373		2.546	.012		
Information technology	.313	.057	.410	5.522	.000	.478	2.091
Loan lending system	.144	.056	.174	2.589	.011	.582	1.719
Motivation of employees	.004	.078	.003	.046	.963	.577	1.733
Management system	.025	.066	.025	0.385	.701	.642	1.558
Effective risk management	.029	.059	.042	0.488	.626	.349	2.869
Regulatory framework	.348	.062	.417	5.623	.000	.480	2.083

The regression equation based on the coefficient of variables can be inferred as:

MP = 0.949+ 0.313IT+ 0.144LLS+0.004ME+ 0.025MS + 0.029ERM + 0.348RF

Where,

MP (est.) = Performance of MFIs (MP, representing MFIs Performance) as a dependent variable.

IT = Information Technology

LLS = Loan Lending System

ME = Motivation of Employees

MS= Management System

ERM = Effective Risk Management &

RF = Regulatory Framework as an independent variable.

4.3 Hypothesis Testing

Hypothesis testing: To deduce the outcome of a hypothesis tested on sample data from a broader population, hypothesis testing is utilized.

Table 6 shows staff motivation, management system, and effective risk management, which showed an insignificant relationship with the performance of MIFs in Nepal, information technology, loan lending system, and regulatory framework have been accepted as showing a significant positive relationship between the performances of MFIs.

Table 6
Summarized Hypothesis Result

Hypothesis	Conclusion
Information technology	Accepted
Loan lending system	Accepted
Motivation of employees	Rejected
Management system	Rejected
Effective risk management	Rejected
Regulatory framework	Accepted

5. DISCUSSION AND CONCLUSION

This study's goal was to learn more about the factors that affect MFIs' operational effectiveness in Nepal. This study employs multiple regression analysis to identify probable drivers of MFI performance. Six significant criteria were found using previous literature as a guide. The study's findings indicate that three variables—information technology, the loan-lending system, and the regulatory framework have a major beneficial impact on how well microfinance firms operate. Effective risk management, management processes, and staff motivation all have a small but positive impact on how well MFIs operate. The regulatory structure of microfinance institutions, on the other hand, has the greatest impact on the MFIs' overall performance in Nepal. The study found out that the information technology, loan lending system, and regulatory framework were the most determining factors that enhance the operational performance of MFIs. In contrast to information technology, which has little impact on MFIs performance, Akhter (2018) found that the lending system, staff motivation, proper management system, effective risk management approach, and government regulatory framework all significantly influence MFIs performance, which is just opposite in the context of Nepal as information technology was the most prominent factor that effects on the performance of MFIs. The difference in results occurs between Nepal & Bangladesh as per the difference in socio-culture, tradition, geography structure, working culture, workforce diversity, and nature and types of MFIs. Similarly, Hartungi (2007) a simple, transparent system, supervision, audit capacity, and financial procedures state the regulatory framework contributes to success as well. Kombo et al. (2011), government subsidies are the most popular sources of funding for improving the performance of MFIs, which is related to the finding of this research i.e. government must provide the various subsidies like: lower interest rates in deprived sector borrowing, favorable economic conditions, supportive monetary and fiscal policy.

Microfinance institutions are internationally renowned organizations that have operated to help the nation's underprivileged (Meisami & Royaee, 2011). This study will assist academics, researchers, managers, BFIs, MFIs, and rule makers in building their knowledge of the critical elements affecting the performance of microfinance institutions. This study demonstrates that the

only factors significantly influencing MFIs performance in Nepal are information technology, loan lending systems, and the regulatory environment. The findings of the study will benefit the MFIs stakeholders like investors, operators, regulators, policymakers, banks, etc. It will help them acknowledge factors affecting the success MFIs in Nepal and the actions that may be brought in, as a result, to enable them to flourish. Finally, the suggestion for additional research that this study did not address is also given so that future researchers can assess the performance of MFIs in Nepal in greater detail and take into account additional factors to draw a more trustworthy and valid conclusion.

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