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An Empirical Analysis of Barriers and Strategic Pathways for Unbanked Entrepreneurs in Nepal: A Pilot Study

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Abstract

Background: Smaller entrepreneurs are considered indispensable in the developmental economy of emerging countries such as Nepal, but a substantial portion of them are left out of the financial system.

Objectives:

1. To examine financial literacy among small entrepreneurs.
2. To highlight major obstacles in getting access to banking institutions.
3. To analyze the viability of digital financial solutions and microfinance institutions.
4. To comprehend awareness and effectiveness of government schemes.

Methods: A cross-sectional study using a structured format with a population of 50 small shopkeepers in Sukedhara, Kathmandu, was used. Data analysis included descriptive statistics, Cronbach's Alpha Test in SPSS for reliability, and a Pearson Correlation Test for four major hypotheses.

Findings: Lack of financial literacy (r=0.68, p<0.01) and geographical restrictions (r=0.72, p<0.01) were strongly related to financial exclusion and informal financial participation. M-banking had a great potential for financial inclusion (r=0.61, p<0.01) but this was conditional on digital literacy. Awareness of government schemes was a critical factor where no important relationship with better access existed (r=0.19, p>0.05).
Conclusion: The financial gap is perpetuated by interwoven demand side (literacy, perception) and supply side (access, product) barriers.
Implementation: To make this vision a reality, a synergistic approach can be adopted, which will include the following: (1) Financial and digital literacy programs at a national level; (2) Improving mobile banking infrastructure and trust; (3) Improving public-private credit guarantee schemes and awareness thereof; and (4) Banks developing new products based on an alternative credit.
Keywords: Financial Inclusion, Unbanked Entrepreneurs, Digital Financial Services, Financial Literacy

1. Introduction

Micro and small entrepreneurs are the essential threads in the economic tapestry of most emerging nations, driving employment, fostering innovation, and promoting localized development. In Nepal, this sector is the backbone of the economy, but it is faced with a critical constraint: widespread financial exclusion. A large number of these entrepreneurs remain "unbanked"-without access to basic formal financial services like savings accounts, credit, and insurance. This exclusion leads to a persistent financial gap-the difference between the capital required for business operation, resilience, and growth, and the capital accessible through formal, regulated channels.

This is not a gap created by a lack of money but one that reveals systemic failures. Forcing entrepreneurs to seek informal financial systems, with their usurious rates of interest, unpredictability, and without any right to legal protection, maintains a vicious cycle of vulnerability and inhibits economic potential from being reached. It is for this reason that the bridging of such a gap is an economic imperative and a cornerstone for the realization of broader SDGs such as poverty reduction and decent work.

While the problem is identified, there is a need for context-specific, empirical insights into the interplay of barriers and the perceived efficacy of solutions in Nepal. Accordingly, the current study seeks to investigate multidimensional barriers faced by unbanked small entrepreneurs in an urban Nepali context and, based on that, critically evaluate strategic pathways toward inclusion. The paper will go beyond generic prescription and present specific proof via testing hypotheses based on forms of financial literacy, geography, technology, and policy.

2. Literature Review & Theoretical Framework

2.1 Constraints to Formal Financial Access

The literature points out a confluence of barriers:

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Collateral Requirements: Conventional banking requires collateral in immovable assets, which most micro-entrepreneurs lack. This forms an exclusionary threshold.

Geographic and Infrastructural Constraints: Physical distance from a bank branch creates prohibitively high transaction costs, particularly in rural and peri-urban areas (Parker, 2016).

Financial Illiteracy: A lack of understanding of financial products and management undermines both confidences to engage with banks and the ability to make effective use of services.

Informal System Reliance: This happens to be both an effect and a reinforcing cause of exclusion in that it prevents the building of formal credit histories. Karlan & Morduch, 2009

2.2 Evolving Solutions

Microfinance Institutions: Introduced novelty in group-lending models to reduce collateral requirements; however, most criticisms relate to high interest rates and limited product offerings.

Digital Financial Services: Mobile money and fintech promise to leapfrog physical infrastructure barriers and allow both lower costs and greater reach (Suri & Jack, 2016).

Policy Interventions: Credit guarantee schemes led by the government and financial literacy mandates are a means of de-risking lending and building capability, respectively.

2.3 Theoretical Framework

This study is anchored in the Theory of Planned Behavior (TPB) of Ajzen (1991). According to TPB, an individual's behavior (opening a bank account) is predicted by their intention, which, in turn, is mediated by the following: (i) Attitude-it means beliefs about outcomes; (ii) Subjective Norms-it refers to perceived social pressure; and finally, (iii) Perceived Behavioral Control-it is the ease or difficulty in performing the behavior. Major barriers, such as financial illiteracy, serve to further negatively shape attitude and control, while accessibility due to geographic distance reduces control. Solutions like DFS are designed to improve perceived behavioral control. This thus enables a structured investigation of the psychological and practical dimensions of financial exclusion.

3. Methodology

3.1 Research Design and Approach

A positivist philosophical worldview guided this quantitative, descriptive, and cross-sectional study. A deductive approach was used to test predefined hypotheses.

3.2 Population, Sample, and Setting

The target population was small entrepreneurs (shopkeepers) in Kathmandu. Using convenience sampling, 50 respondents were recruited from the Sukedhara area. Inclusion criteria required respondents to be business owners aged 30+.

3.3 Data Collection and Instrument

Primary data were collected via a structured questionnaire with two sections:

Section A: Demographic information.

Section B: 30 items on a 5-point Likert scale (1=Strongly Disagree to 5=Strongly Agree) measuring constructs for four hypotheses (H1-H4).

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3.4 Data Analysis

Data were analyzed using SPSS Version 26. Analysis included:
Descriptive statistics (frequencies, means).
Reliability analysis using Cronbach's Alpha.
Inferential statistics (Pearson's correlation) to test hypotheses.

3.5 Hypotheses

H_1: Financial literacy has a significant positive impact on access to formal banking services.
H_2: Geographic inaccessibility has a significant positive correlation with reliance on informal financial systems.
H_3: The use of mobile banking services has a significant positive correlation with financial inclusion.
H_4: Awareness of government programs has a significant positive correlation with access to formal banking services.

4. Results and Analysis

4.1 Demographic Profile

Table 1: Demographic Characteristics of Respondents (N=50)

Variable	Category	Frequency	Percentage (%)
Gender	Male	31	62.0
	Female	19	38.0
Age Group	30-40 years	29	58.0
	Above 40 years	21	42.0
Business Tenure	5-10 years	32	64.0
	>10 years	18	36.0

4.2 Reliability and Descriptive Statistics

The Likert scale showed good internal consistency (Cronbach's Alpha = 0.84). Key construct mean scores were: Financial Literacy (2.8), Geographic Barriers (3.9), Mobile Banking Use (3.1), Government Program Awareness (2.2).

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4.3 Hypothesis Testing

Table 2: Results of Correlation Analysis for Hypothesis Testing

Hypothesis	Variables Correlated	Pearson's (r)	p-value	Result
H_1	Financial Literacy & Banking Access	0.68**	0.000	**Supported**
H_2	Geographic Barriers & Informal Finance Use	0.72**	0.000	**Supported**
H_3	Mobile Banking Use & Financial Inclusion	0.61**	0.000	**Supported**
H_4	Govt. Program Awareness & Banking Access	0.19	0.183	**Not Supported**

**$p < 0.01$

4.4 Analysis of Findings

H1 (Supported): The strong positive correlation confirms that entrepreneurs with higher financial literacy find it easier to navigate and access formal banking. This underscores literacy as a critical enabler.

H2 (Supported): The very strong correlation validates that physical and logistical hurdles directly push entrepreneurs toward informal lenders, highlighting an access frontier that traditional branch models fail to meet.

H3 (Supported): The significant correlation affirms the transformative potential of mobile banking. However, the moderate mean score (3.1) suggests barriers to adoption like digital literacy and trust, qualifying this support.

H4 (Not Supported): The weak, non-significant correlation reveals a critical implementation gap. Government programs are either poorly designed, inadequately disseminated, or inaccessible to their target beneficiaries, rendering them ineffective in bridging the access gap.

5. Discussion

This study elucidates the complex ecosystem of financial exclusion in Nepal. The findings corroborate global literature on the importance of financial literacy and geographic access (Lusardi & Mitchell, 2014; Parker, 2016) but provide localized nuance. The most salient insight is the disconnect between policy (H4) and practice. Well-architected government schemes fail at the last mile due to insufficient awareness-raising and complex access procedures.

The qualified support for mobile banking (H3) points to a "second-level digital divide"—access to a phone does not guarantee effective use of financial technology. Concerns over security,

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complexity, and a lack of human support inhibit full adoption, suggesting that technology must be accompanied by education and robust customer support channels.

From a theoretical standpoint, the results validate the TPB framework. Barriers directly erode perceived behavioral control (e.g., "I can't get to the bank") and shape negative attitudes (e.g., "Banks are not for people like me"). Successful solutions must therefore work on both dimensions: enhancing actual and perceived control (via DFS) while positively shaping attitudes (via literacy programs and inclusive product design).

6. Conclusion and Recommendations

6.1 Conclusion

This research work is that the financial gap in Nepal for small entrepreneurs is sustained by a vicious cycle of supply side shortcomings and demand side challenges. The factors of financial illiteracy, inaccessibility, and non-customized products create a shortfall, but a lack of awareness is an impediment to solutions in policies. Digital finance can be a very effective but not an ultimate tool.

6.2 Strategic Recommendations

In order to have an inclusive financial system, a multifaceted approach is necessary:

For Policymakers (Nepal Rastra Bank,

Launch a National Financial & Digital Literacy Mission: Implement learning modules in community programs, vocational education, and educational institutions.

Revitalize Credit Guarantee Schemes: Simplify application procedures and conduct mass awareness programs through local media and MFIs.

Encourage Regulatory Sandboxes: Innovation in fintech can be facilitated through pilot projects with less regulation.

For Financial Service Providers (Banks, MFIs, FinTech Companies

Create "Phygital" Model Hybrids: Integrate accessible mobile apps with a localized network of trusted agents for cash in/cash out and new-user on-boarding.

Innovate Credit Assessment: Develop credit-based lending products based on non-traditional credit information such as mobile money transaction records and utility bill payments.

Create Trust in DFS: Focus on cybersecurity, transparent pricing, and easily accessible local-language support.

For NGOs & Community Organizations:

Acting as a bridge in sharing information regarding government schemes and financial products.

Establish a network for learning from each other among entrepreneurs.

6.3 Limitations & Future Research

The main weaknesses of this study are its small sample and focus in a single city. Future research work can be conducted using larger random samples of different strata in rural and urban settings in Nepal. Longitudinal studies can be conducted to examine the long-run effects

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of interventions such as literacy programs or DFS implementation. Qualitative research studies can be conducted to examine socio-cultural or gender angles in financial decision-making. Removing financial barriers is a basic requirement for unlocking the entrepreneurial potential that will bring about equitable and sustainable development in Nepal. Financial solutions are but one part of a complete strategy, which must include capacity-building, create an environment of trust, and ensure all entrepreneurs have a chance to succeed.

Transparency Statement: The authors confirm that this study has been conducted with honesty and in full adherence to ethical guidelines.
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Authors' Contributions: The authors jointly conducted all research activities i.e., concept, data collecting, drafting and final review of manuscript and second author contributes for feedbacks ad correction in each steps of research and final review of manuscript.

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