

# **COMPLIANCE ISSUE OF MICROFINANCE INSTITUTION AND PROFITABILITY ANALYSIS**

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## **CERTIFICATE OF AUTHORSHIP**

I hereby corroborate that I have researched and submitted the final draft of dissertation entitled “COMPLIANCE ISSUE OF MICROFINANCE INSTITUTION AND PROFITABILITY ANALYSIS” The work of this dissertation has not been submitted previously for the purpose of conferral of any degrees nor has it been proposed and presented as part of requirements for any other academic purposes.

The assistance and cooperation that I have received during this research work has been acknowledged. In addition, I declare that all information sources and literature used are cited in the reference section of the dissertation.

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## **REPORT OF RESEARCH COMERMTTEE**

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Laxman Giri  
Researcher

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## ABBREVIATIONS

ADB/N	-	Agriculture Development Bank of Nepal
ASA	-	Association of Social Advancement
CECI	-	Central for International Studies for Co-operative
CSD	-	Center for Self-help Development
DDC	-	District Development Committee
DEPROSE	-	Development Project Service Center
FINGO	-	Financial Intermediary Non- Government Organization
INGO	-	International Non-Governmental Organizations
MP	-	Increase In Income
LRF	-	Limited
MFDB	-	Micro Finance Development Bank
MF	-	Micro Finance
MFI	-	Micro Finance Institutions
NBL	-	Nepal Bank Limited
NRB	-	Nepal Rastra Bank
NCD	-	National Co-operative Development Bank
NGOs	-	Non-Governmental Organizations
PAR	-	Poverty Alleviation Reduction
RMDC	-	Rural Micro Finance Development Center
SACCO	-	Saving and Credit Co-operative
CBS	-	Central Bureau of Statistics

## ABSTRACT

The objective of this study is to analyze the effect of compliance issue of microfinance institution on the profitability analysis of Nepal. The descriptive statistics provide a foundational understanding of the distribution and variability of key variables, shedding light on the average performance level of MFIs in Nepal (MP) and the extent of variability within the sampled institutions. This insight suggests that while some MFIs may perform relatively well, there are others experiencing significant challenges or variations in performance, which could be attributed to a multitude of factors including operational inefficiencies, market dynamics, or regulatory constraints. Moreover, the correlation analysis reveals intriguing patterns of association between MFI performance and operational components such as loan lending systems, management practices, risk management effectiveness, and regulatory frameworks. The significant positive correlations with effective risk management and regulatory compliance underscore the pivotal role of these factors in driving MFI profitability. While these findings do not necessarily imply that these aspects are inconsequential, they do suggest potential areas for improvement or optimization. For instance, enhancing loan lending systems to streamline processes, improve access to credit, or mitigate default risks could yield tangible benefits for MFI profitability. Likewise, strengthening management practices, such as strategic planning, human resource management, and performance monitoring, could enhance operational efficiency and effectiveness, ultimately contributing to improved financial performance. Furthermore, By promoting responsible finance practices and embedding environmental, social, and governance (ESG) considerations into their operations, MFIs can amplify their positive impact on society and contribute to the achievement of sustainable development objectives. In last, the journey towards addressing compliance issues within the microfinance sector is not merely a quest for regulatory adherence or financial performance but a transformative endeavor with profound socio-economic implications.

*Keywords: Performance of MFIs, Lending System, Management System, Effective Risk Management, Regulatory Framework*

# CHAPTER- I

## INTRODUCTION

### 1.1 Background of the Study

Microfinance is not a new phenomenon. It has been defined differently by different people, agencies and institutions (Singh & Gashayie, 2014). Previously, microfinance was known as ‘microcredit’ which means small loan provided especially to women to start micro businesses that help to improve their living standard (Yunus, 2003). However, ‘microfinance’ has changed over the years to align with customers’ needs and demands. In recent years, the concept of microfinance has expanded from being limited to microcredit and female borrowers and has been defined as the provision of financial and non-financial services from microfinance institutions to low-income households and small businesses in rural and urban areas (Robinson, 2001) while the institutions that provide these microfinance services are referred to as microfinance institutions (Ledgerwood, 1998). Microfinance has evolved from microcredit to products and services such as micro loans, savings, remittance, insurance, training and development.

One of the major issues many developing countries face is poverty alleviation. In 2001, the world bank estimated more than 1.1 billion people were poor and depending on less than \$1 a day and another 2.7 billion lived on less than \$2 a day (Sengupta & Aubuchon, 2008). The literature shows that there is no single definition of poverty or way of measuring poverty. The Consultative Group to Assist the Poorest (CGAP) broadly defines poverty as the situation where the individuals are living below the poverty line. The current quantitative measurement of poverty is ‘a dollar a day’ (Tache & Sjaastad, 2010). About 75% of people in developing countries live in extreme poverty in rural areas, mostly dependent on agriculture for their livelihood (World Bank, 2007). A considerable number of governments and international communities have applied various strategies to reduce poverty. Despite these efforts, there has been little impact on poverty, mainly because traditional banks are reluctant to provide credit to poor people in developing countries due to high risks and costs (Sohn & Ume, 2019).

Over the last two decades, a substantial number of commercial MFIs have started to emerge with the intention of profit maximisation, which demonstrates that the purpose

and practice of MFIs have dramatically changed. MFIs' main purpose as non-profit organisations was to support low-income households by providing microfinance services; however, they increasingly started to adopt a commercial approach by systematically reducing the dependency on subsidies and financial aid. They began to focus on self-sustainability and targeting relatively fewer poor borrowers to cover the cost. Profits are viewed as not only acceptable but essential because they are expected to attract investors (Ghalib et al., 2015).

Since launching its planning initiatives in 1956, the government of Nepal has been focused on reducing poverty. Its many periodic plans show the policies and initiatives aimed at reducing poverty. As the bulk of impoverished people were seen to be impoverished because they lacked basic necessities, the Sixth Plan concentrated on providing for their needs, while the Tenth Plan prioritised reducing poverty. The plan created the Poverty Reduction Strategy Paper (PRSP), which is composed of four main pillars: social development, targeted programmes, targeted economic development, and good governance. The Poverty Alleviation Fund (PAF) programme was created by the PRSP to aid the underprivileged. Through income-generating initiatives, raising awareness, and other means in the districts affected by poverty, PAF has been attempting to improve the living conditions of the poorest of the poor. The UN established the Millennium Development Goals (MDG) in 2001, with the aim of achieving progress in several areas by the year 2015, such as ending extreme poverty, ensuring that every child attends primary school, and halting the spread of contagious illnesses (HDR, 2015). Through the establishment of the Grameen Bikas Kendra (Rural Bank Centre) in 52 VDCs across the nation, Nepal Rasta Bank (NRB) started working with the underprivileged. In order to qualify for a loan, the Bank categorised the poor as those who own less than 20 ropanis in the hills and less than 1 hectare (1.5 bigha) of arable land in the Tarai. The bank has started a number of initiatives to reduce poverty, such as lending, credit revolving funds, loan repayment, monitoring and assessment, auditing, and training (NRB, 2022).

Nepal is the poorest nation in South Asia and among the world's poorest nations overall. Its rate of reducing poverty is really poor. In the final ten years of the 20th century, microfinance has gained acceptance as one of the major drivers of the fight against poverty. In Nepal, although the rate of poverty reduction is sluggish, the standard of living can be enhanced relatively quickly in the Hill and Terai regions if

an appropriate model is applied. The variety of regulatory acts demonstrates the necessity of licencing, regulating, overseeing, and creating national microfinance policy under a single act for all MFIs. Experience in Nepal demonstrates that MFIs in the private sector do better than those in the government.

Microfinance is a financial system and an effective tool that helps the poor pull themselves out of poverty. The definition of microfinance has been defined differently by many people and organizations. According to Ledgerwood (1999), microfinance involves the provision of a variety of financial services, such as deposits, loans, payment services, money transfers, and insurance, to low-income individuals, households, and their small companies. The provision of several financial services, including as deposits, loans, payment processing, money transfers, and insurance, to low-income people and their microbusinesses is known as microfinance. The pioneers of microfinance wanted to give formal financial services to the impoverished, who were denied access to banks because of their limited means, low demand for credit, and lack of collateral for loans (Armendariz, 2011).

MFIs provide microfinance services to the underbanked, or people at the bottom of the pyramid who are usually considered unbendable by regular banking institutions. The majority of the loans in their portfolio are unsecured group loans. During a gathering, they lend to and receive from participants. Lockdown protocols and the prohibition on public meetings because of fears about the spread of disease hindered MFI field activities. Additionally, MFI borrower income was negatively impacted and loan repayment was hindered by the stoppage of the majority of economic activities, with the exception of a few critical enterprises. Even if Covid-19 impacts almost every nation, the effects may range from nation to nation and within a nation, various sectors may bear different costs. Consequently, it is imperative to thoroughly scrutinize the extent of impact on diverse industries from several perspectives. Practically every area of the economy has been negatively impacted by COVID-19, but small businesses and those with low incomes are disproportionately impacted since they have fewer resources to assist them withstand the shock of the current epidemic (Shrestha, 2020).

The way the microfinance industry has evolved has altered how MFIs define organizational success. In addition to societal objectives like ending poverty, empowering women, and guaranteeing that those in need of financial assistance have

access to it (Ledgerwood, 2013). In a market where competition is intensifying, MFIs need to sustain robust financial ratios and financial performance to survive and prosper (Gutierrez, 2010). Because of this, a lot of MFIs implement a double-bottom line approach, however they differ slightly in how much emphasis they place on it. Non-profit MFIs usually lay greater emphasis on their social performance, whereas for-profit MFIs are primarily focused on reaching well-defined financial goals (Mersland, 2009). Furthermore, the competitive climate has made efficiency a crucial element of organizational success for both kinds of MFI (Hermes, 2011).

Today's microfinance institutions are closely watched by academics, legislators, information seekers, and development professionals. This review has valuable insights for both professionals and academics. Specifically, our contribution provides a comprehensive framework for managing-focused MFI research, setting the stage for future growth of management-relevant MFI research. The several trends that influence the performance of MFIs in Nepal are the main subject of this study. Examining the factors influencing the performance of Nepal's microfinance sector is the primary objective of this study. The precise objectives of this study include an analysis of the factors that influence the functioning of MFIs in Nepal and a look at how information technology, loan lending systems, motivated employees, risk management, and management system regulations work.

## **1.2 Problem Statement**

Microfinance programmes have the capacity to change the balance of power and give impoverished men and women more influence. Even though women now have more access to financial services than they did ten years ago, their ability to take advantage of this access is frequently still constrained by disadvantages associated with their gender. Even while these organisations are expanding and adding new loan products, a smaller percentage of loans from certain MFIs are going to low-income women. Additionally, even when women belong to the same demographic group and community as males, their average loan quantities are less than those of men.

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).

The contribution of this study, 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.

- i) What is the present status of compliance issue of microfinance institution and profitability analysis of Nepal?

- ii) Is there any relationship between the compliance issue of microfinance institution and profitability analysis of Nepal?
- iii) Whether the compliance issue of microfinance institution effect the profitability analysis of Nepal?

### **1.3 Objectives of the study**

The key objective of this study is to analyze the effect of compliance issue of microfinance institution on the profitability analysis of Nepal. The specific objectives of this study are as follows:

- i) To assess present status of compliance issue of microfinance institution and profitability analysis of Nepal;
- ii) To examine relationship between the compliance issue of microfinance institution and profitability analysis of Nepal;
- iii) To analyze the effect of compliance issue of microfinance institution on the profitability analysis of Nepal.

### **1.4 Rationale of the Study**

The rationale behind this study is to investigate the critical interplay between compliance issues within microfinance institutions (MFIs) and their profitability in the context of Nepal. Given the pivotal role MFIs play in fostering financial inclusion and supporting the economic empowerment of low-income populations, understanding how regulatory compliance impacts their financial performance is crucial. The study aims to provide a comprehensive assessment of the current state of compliance and profitability among Nepalese MFIs, explore the nature and strength of the relationship between compliance practices and profitability outcomes, and analyze the direct effects of compliance on financial performance. This research will offer valuable insights for policymakers, financial regulators, and MFI management, helping to optimize regulatory frameworks and operational strategies to enhance the sustainability and profitability of MFIs in Nepal.

### **1.5 Limitations of the study**

The study has the following limitations:

- i) Primary data and information gathered during the field visit form the basis of the study. The short-term analysis, which compares a small number of variables and instruments.
- ii) The findings of the study may not be generalizable to microfinance institutions in other countries due to differences in regulatory environments and economic conditions.
- iii) Challenges in accurately measuring compliance levels, as compliance issues may be qualitative and subjective, could affect the reliability of the results.
- iv) External factors such as economic fluctuations, political instability, and natural disasters, which also affect profitability, may confound the relationship between compliance and profitability.
- v) Differences in operational practices and business models among various microfinance institutions might lead to variability in the impact of compliance issues, complicating the analysis.

## **CHAPTER-II**

### **LITERATURE REVIEW**

#### **2.1 Theoretical Review**

Additionally, the government implemented a 20-year Poverty Reduction Plan from 1997 to 2017, with the goal of bringing poverty down to 10% by the completion of the programme. Nevertheless, the poverty statistics indicated earlier suggest that this goal will not be accomplished by 2017. In order to reduce poverty in a sustainable way, three things must happen: (i) faster and more widespread economic growth that benefits the poor will create jobs and raise rural incomes; (ii) fair improvements in basic social services will improve human development; and (iii) excellent governance.

Numerous community-oriented policies and programmes with various goals pertaining to economic growth, national development, nation-building, or just development were implemented throughout Africa. Examples of well-known initiatives in and outside of Africa include the green revolution, the agricultural development projects (integrated rural development projects), the special rural development programme in Kenya, and the Operation Feed Yourself initiative in Ghana. The majority of these programmes and policies were created with the intention of improving the socioeconomic standing of the rural populace. According to Adamu (2007), microfinance programmes have been seen as a special way to reduce vulnerability and so help accomplish the Millennium Development Goals.

The key to escaping hunger is for the impoverished to diversify and augment their sources of income through microfinance. Diversity increases a person's resistance to shocks from the outside world. The study of poverty alleviation was not a recent development. Instead, the spatial variations in poverty levels among actual units are reviewed. Poverty is a universal condition that has varying effects on people, nations, and continents. People experience it at different times and stages of life, in varied depths and intensities (Oyeyomi, 2003). Based on income or consumption line, poverty is most frequently measured. If someone's daily consumption is less than \$1 USD, which is the minimum required to meet basic necessities, they are deemed to be impoverished. The poverty line is the name given to this lowest point (The World Bank, 2022).

### **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).

According to the Central Bank of Nigeria (1999), poverty is defined as "a state in which an individual has limited access to social and economic infrastructure such as education, health, portable water, and sanitation; and consequently, has limited chance of advancing his or her welfare to the limit of his or her capabilities." It also includes not being able to meet social and economic obligations, lack of gainful employment, assets, and self-esteem. When Narayan et al. (2000) stated, "don't ask me what poverty is because you have met it outside my house," they provided a methodical definition of the condition. Count the holes in the home by taking a look at it. Take a look at my kitchen tools and my attire. Take note of everything you observe as you look at it. Poverty is what you perceive. The word "micro-finance" describes a variety of strategies for providing financial services to underprivileged individuals. According to Irobi (2008), microfinance is the supply of financial services, such as savings, microleasing, microinsurance, and payment transfers, to low-income and economically active households so they can develop their small businesses or engage in income-generating activities. A segmental definition of microfinance is a type of financial intervention targeted at the low-income segment of a particular society. Credit services make up the majority of the intervention, but savings, insurance on credits, and savings are also possible. In addition, Robinson (2001) described microfinance as providing the underprivileged with loans, savings accounts, and other essential financial services. Microfinance developed as a strategy for economic development aimed at helping the underprivileged members of a community, both male and female (Irobi, 2008). The World Bank (2022) defines the phrase as the provision of financial services, such as credit and savings, to the underprivileged. Thus, microfinance banks are organisations created to offer financial services to the underprivileged. Non-governmental organisations, savings and loan cooperatives, loan unions, government banks, commercial banks, and non-bank financial institutions are examples of microfinance institutions (Ledgerwood, 1997).

Through privately held businesses, the strategy aims to provide low-income people, the economically engaged poor, and micro, small, and medium-sized businesses with sustainable access to financial services. According to Otero (1999), the goal of microfinance is to establish an institution that provides financial services to the impoverished, who are neglected by the formal banking sector. Previous research on

microfinance has assessed whether microcredit programmes, like those that are widely used in Nigeria, are accessible to the relatively poor and vulnerable. According to recent research, microfinance has a favourable influence on the first six of the seven Millennium Goals (Irobi, 2008). These findings support the notion that microfinance is a potent instrument for reducing poverty. Amin, Rai, and Topai (2003), for instance, highlight how microfinance can assist those who are impoverished and confirm that it has benefited both those who are below and over the poverty line. Furthermore, Hossain (1988) discovered that Grameen members who are impoverished and landless have an average household income that is 43% greater than that of marginal landowners in his study "Credit for the Alleviation of Rural Poverty in Bangladesh" (Jegeole, 2011).

### **2.1.3 Microfinance**

The term "microfinance" describes the wide variety of financial services that are offered to low-income and impoverished households and their microbusinesses, including deposits, loans, payment services, money transfers, and insurance. Microfinance encompasses not just financial services but also non-financial support like business advisory and training. In Tanzania's rural and urban areas, licenced commercial banks, regional and rural unit banks, savings and credit cooperative societies, and a number of non-governmental organisations (NGOs) whose micro-credit delivery operations are funded and supported with technical assistance by international donors are the main providers of financial services to the poor and low-income households (Kessy & Urio 2006).

Formal microfinance programmes (MFps) are governed by the nation's financial authorities and comprise rural banks, agricultural development banks, certain commercial banks, and financial enterprises with dedicated microfinance windows. semi-formal MFps governed by non-financial authorities (unregulated village banks and credit, cooperatives for savings and credit). Unguitous Rotating Saving & Credit Associations, savings and credit associations with permanent loan funds, doorstep deposit collectors, and the numerous self-help groups with some restricted financial activities are examples of informal MFps governed by customary law and peer pressure (Nyanda, 2015).

Before the early 1980s, when organisations like Grameen Bank effectively extended small loans to a wide number of people, microfinance organisations were barely known (Wrenn, 2005). Beginning in 1976 with a 27 USD loan from Muhammad Yunus to 42 individuals, microcredit has expanded to become an international endeavour with a loan portfolio of 43 billion dollars.

After that, the effects of microfinance institutions were not as noticeable until the 1990s, which saw an acceleration in the global microfinance industry's expansion. The 1990s are referred to by Dichter as the "microfinance decade." With more than 10,000 microfinance institutions operating in numerous nations, microcredit has grown to serve 500 million borrowers annually, generating €50 billion in revenue. Muhammad Yunus's visionary mission of helping the poorest of the poor is, according to Valadez and Buskirk (2010), evolving into a system that no longer functions as a compensatory social institution as was his intention, but rather as a self-sustaining business that lends low-cost money while offering investors a respectable return.

The argument made by those who support microfinance is that the sector has been crucial to development, particularly in developing nations. Since microfinance provides productive capital to the impoverished who are shut out of the official banking system, it aids in the exodus of people from poverty. According to Bandura (1997), when the impoverished are able to use natural resources to produce things or provide services, they will feel more capable. He goes on to say that once they reach their goals through their labour, having the cash to accomplish this will boost their confidence and sense of worth. Sara (2011) affirms that microfinance, particularly for women in developing nations, is a potent instrument for empowering the impoverished globally. D'espallier et al. have characterised microfinance as an effective strategy that promotes peoples' gender equality (Nabayinda, 2014).

Microfinance is the provision of financial services to the impoverished in the form of modest loans to initiate or grow their small business. This could raise their standard of living by increasing their earning potential and empower women by giving them the ability to make financial decisions and reduce poverty. Poor business owners and low-income households without collateral or without access to traditional bank loans can apply for microfinance. In addition to helping already-existing businesses expand by diversifying their operations and addressing poverty among the impoverished in

emerging nations, microfinance programmes were established with the goal of fostering microenterprises.

Microfinance is defined as the provision of financial services, including deposits, loans, payment processing, money transfers, and insurance, to low-income and impoverished households and their microenterprises by the Asian Development Bank (ADB), located in Manila.

As a result, microfinance involves providing financial services like savings, loans, and insurance to impoverished people living in both urban and rural settings who are unable to obtain such services from the formal financial sector. Schreiner and Colombet define microfinance as “the attempt to improve access to small deposits and small loans for poor households neglected by banks” (Schreiner & Colombet, 2001).

The definition of microfinance was aptly summed up by the 2000 Microcredit Summit Campaign: "Microcredit is about much more than access to money." It's about giving people power over their means of subsistence. It is about women rescuing themselves from vulnerability and poverty. It is about empowering individuals in their homes, villages, and nations on an economic and political level (Shakya, 2016).

This section covers some basic information regarding the definition, development, and present practices of "microfinance," as well as the methods used by numerous organisations that engage in this line of work. In order to familiarise readers with this topic, a brief overview of some of the most well-known and prosperous microfinance organisations globally has been provided. The Bangladesh Rural Advancement Committee (BRAC), Shore Bank, and Grameen Bank are these. Microfinance is the provision of financial services to economically active low-income households, such as credit (loans), savings, microleasing, microinsurance, and payment transfers, to enable them to take part in income-generating activities or to develop and grow their small companies. Once more, MF is described as a type of financial intervention that targets the underprivileged segment of a certain community. Credit services make up the majority of the intervention, but savings, insurance on credits, and savings are also possible.

Microfinance (MF) has developed into a strategy for economic development aimed at helping the underprivileged members of a particular community, including both men and women. The phrase refers to "provision of financial services" (including credit and savings) to "the poor," under the World Bank definition. The purpose of

microfinance banks is to offer financial services to the economically engaged poor. Non-governmental organisations (NGOs), credit unions, government banks, commercial banks, savings and loan cooperatives, and non-bank financial institutions are examples of microfinance institutions (MFIs) (Ledgerwood, 1999). Through privately held banks, this strategy aims to provide low-income earners, the economically engaged poor, and micro, small, and medium-sized companies (MSMEs) with sustainable access to financial services.

This programme provides small loans to households without access to banks in the formal sector. One noteworthy characteristic of microfinance is its apparent success in intentionally reaching out to low-income women residing in various socioeconomic contexts. For example, the Association of Social Advancement (ASA), one of Bangladesh's most well-known microfinance organisations, has given US\$200 million to female borrowers only. In Malawi, women borrowers receive 95% of the loans made available by the Malawi Muzdi Fund. Over 200,000 low-income women have received loans from Women's World Banking since 1979. Locations such as Asia, Africa, and Latin America also have similar cases. These impoverished people's lives are greatly improved by the lending facilities. Their quality of life has increased, and they may now access more sustainability, increased market share, and overall corporate growth potential (Irobi, 2008).

Microfinance is the provision of financial services to economically active low-income households, such as credit (loans), savings, microleasing, microinsurance, and payment transfers, to enable them to take part in income-generating activities or to develop and grow their small companies. Once more, MF is described as a type of financial intervention that targets the underprivileged segment of a certain community. Credit services make up the majority of the intervention, but savings, insurance on credits, and savings are also possible. Microfinance (MF) has developed into a strategy for economic development aimed at helping the underprivileged members of a community (male and female). The phrase refers to "provision of financial services" (including credit and savings) to "the poor," under the World Bank definition. The purpose of microfinance banks is to offer financial services to the economically engaged poor. Non-governmental organisations (NGOs), credit unions, government banks, commercial banks, savings and loan cooperatives, and non-bank financial institutions are examples of microfinance institutions (MFIs) (Ledgerwood, 1999). Through privately held banks, this policy aims to provide low-income earners,

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#### **2.1.4 Models of microfinance**

##### **1. Grameen model**

Prof. Mohammed Yunus established the Grameen model in Bangladesh, with women from low-income families serving as the primary borrowers. In this strategy, a bank manager and employees go to villages to inform the locals about the goals and methods of the bank's operations. In the initial phase, two of every five group members get a loan. After then, the groups are observed for a month to make sure they are abiding by the bank's regulations. Only when the first two borrowers have paid back their loans in full, including interest, during the fifty-week loan period may the remaining group member take out a loan. This puts pressure on the team to maintain accurate individual records (NRB, 2014).

##### **2. Group model**

Under this concept, other members exert pressure on a member who is having trouble repaying a loan so that the member can make the repayment as quickly as possible. If,

however, it fails, the entire group will reimburse the loan on that member's behalf (Johnson & Rogaly, 1997).

### **3. Individual model**

This model does not need any group to formulate as micro loan is provided directly to the individual. So there is no peer pressure for repayment (NRB, 2014).

### **4. Community banking**

The majority of organisations using this banking model are NGOs and others, who use it to introduce community development programmes and foster community growth. To address this, formal or semi-formal institutions are established in the community to provide microloans and educate the populace about various financial practices, including income generation and saving (NRB, 2014).

### **5. Bank guarantees**

In this model, a commercial bank assumes the role of a lender, arranging loans from internal sources using member deposits or from external donors or government agencies. Direct loans are given to people or self-organized groups. Banks and NGOs can donate to international guarantees funds established by numerous international organisations including the UN to launch microfinance initiatives (NRB, 2014).

### **6. Rotating saving and credit associations**

This arrangement is set up such that a number of people give a certain amount each month. Then, using a lottery or other agreed-upon manner, this gathered sum is lent to another member, who will repay it with regular or additional monthly contributions (NRB, 2014). Harper (2002) states that this savings and credit paradigm is highly prevalent. According to him, the group's members are typically friends and neighbours, and they are well-liked by the public and offer a chance for social engagement.

### **7. Village banking model**

The Foundation for International Community developed this paradigm in the middle of the 1980s (FINCA). Village Banks are locally run credit and savings organisations that were founded to help people save money, develop a local self-help group, and

give access to financial services in rural areas (Otero & Rhyne, 1994). A village bank typically has between thirty and fifty members. Self-selection is the basis for membership. The bank is funded by loans from the MFps as well as internal member fund mobilisation.

### **2.1.5 Experience of Some Micro Finance Models**

The informal approach is based on the idea of groups. The strategy functions best in situations when donor-sponsored credit is looked upon by groups with weak credit and savings commitments. This creates administrative issues when the groupings are not cohesive and are not voluntary, even if it functions better with a group that willingly forms a revolving savings and credit association (Besley, Coate & Lounie 1993). (i) The group concept—informal lending to the poor—was the foundation of the Grammen Bank experience.

It was established to help Bangladesh's landless population (ii) get financing that was not available through the official commercial banks' lending programmes. Because the groupings were voluntary and cohesive (landless), the programme proved successful. Since then, the programme has been connected to an official microcredit model. It uses peer pressure from other Grammen group members, tight monitoring, and group assurances as operating mechanisms. The model has shown to be quite effective both as a bank for the underprivileged and as a social movement founded on awareness and training principles, thereby enabling the impoverished to participate actively in society. About 1.5 million impoverished people received services from the Grammen Bank as of 1999. It also helped link 60, 000 tiny village banks together and supplied about \$480 million to its clients for emergency finances, small-scale trade, construction, backup funds, or local production credit.

Since non-governmental organisations (NGOs) typically follow gender-specific and sector-specific motivations and adopt the Grammen principles, they are also classified as informal models. There are unions for traders, farmers, and women, among other groups. The Women Finance Association has the most successful microcredit programmes in Ghana and the Gambia. There were reports of a high repayment rate

for the programmes. In 1999, the programme in the Gambia rewarded depositors with interest rates that were higher than the market, specifically between 20 and 50 percent. The village assemblies, not the official institution, set the high interest rate. The assemblies convene to determine the interest rate, the kinds of savings instruments, and the makeup and duties of credit committees. The level of service provided by Ghanaian and Gambian programmers is comparable to the financial sector, notwithstanding their informal credit model of operation (Irobi, 2008).

Esusu: An informal microcredit project that operates in most West African nations, Esusu is a revolving loan plan that originated in Nigeria. The organisations established to run the rotating programmes do so willingly. Members contribute a set amount of money on a regular basis. One participant gathers all of the contributions from everyone at each interval. Each participant takes a turn until the cycle is finished, at which point it is restarted. Esusu serves as a savings mechanism for those who take their turn later. Strong programmes have been implemented to help the target demographic, especially market women in both rural and urban markets, reduce poverty. The East Esusu group has a well-known leader, and NGOs attempting to set up microfinance programmes in metropolitan areas frequently utilise the Esusu as a model.

### **The Formal Model**

The majority of formal institutions that provide credit to the underprivileged have not been effective, which is why the formal microfinance model is based on formal financial institutions like commercial banks, rural/village/community banks, etc. Their failure was attributed to their lack of understanding of the impoverished and to the absence of a stronger bond between the formal and informal sectors of society. One example of a methodology that has been successful in transitioning from an informal to a formal one in providing microcredit to the underprivileged is the Grammen experience. It's been discovered that the impoverished have relatively little credit requirement in comparison to what the formal model can handle, and that the recurring issue of having no collateral also plays a minor role.

Formal microcredit providers have discovered that reaching client groups physically is costly and high in per-client costs. This is partly due to underdeveloped infrastructure, which drives up the cost of providing even the most basic necessities. Furthermore, the majority of microfinance programmes have limited capital bases and lack access to the kind of funding necessary for meaningful scaling up. This is the reason why microcredit could not be effectively provided by commercial banks or development banks, nor could they be considered an alternative to unofficial lending. Nigerian Industrial Development, the Nigerian Agricultural and Cooperative Bank case. Bank and Peoples' findings, which were quite recent, underlined the serious issues with utilising the formal approach as a means of reducing poverty.

The Linkage Model: The previously stated innovation was built upon a framework for connecting informal savings collectors with official institutions. The banks' willingness to learn more about the informal sector and their sincere attempts to fortify group schemes contributed to the microcredit program's successful recovery. The recent meagre formation of the Nigerian Agricultural Cooperative and Rural Development Bank (NACRDB) by the Nigerian Agricultural and Cooperative Bank (NACB), Peoples Bank of Nigeria, and Family Economic Advancement Programme (FEAP) serves as one example.

Additionally, the CBN-backed Bankers Committee plan, which mandates banks set aside 10% of their profit before taxes for equity investments in small-scale businesses, will only indirectly contribute to reducing poverty through joint ventures or the lending window. In Ghana, the informal savings collectors established a registered association with which the bank transacted, providing the structure for connecting them to the country's biggest commercial bank.

The percentage of emu depositors who are able to obtain credit facilities from their emu collectors has increased as a result of this connection. In the two years that the Ghana model was in use, the percentage of loans to deposits increased from 9% to 60%. The plan was developed in response to the finding that more deposits were frequently the result of collectors lending more money. By creating policies to address issues like mistrust, ignorance of informal agents, and bias, formal banks can better strengthen their relationship with the new NACRDB institution. These factors

make formal banks' involvement in informal microcredit riskier (Arp, Ardisa, & Ardisa, 2016).

### **Donors Model**

The microcredit programme has benefited greatly from the contributions of donors, especially those from abroad like the UNDP who work through NGOs. The Ekpuk (family) model, an alternate microcredit delivery strategy put out by Union Gabriel and Itoro O. Ibanga (1997), functioned flawlessly inside an extended family framework and was especially effective in a few villages in Akwa Ibam State. Nonetheless, it is imperative to promote the utilisation of formal credit institutions, including community banks and NACRDB, for this loan distribution system. Strong nonbank financial institutions with a lower default risk has been benefit from it (Akanji, 2010).

### **2.2 Empirical Review**

Udijanto et al. (2024) analyzed financial inclusion strategies by focusing on the bibliometric aspects of microfinance and economic development initiatives. Their study aimed to understand the historical evolution of financial inclusion from theoretical foundations established in 2016 to practical applications and regulatory issues around 2017-2018. Through a detailed historical analysis, the study highlighted how financial inclusion strategies have evolved over time, reflecting changes in theoretical perspectives and regulatory practices. The findings emphasize the importance of continuously adapting financial inclusion strategies to address emerging challenges and leverage new opportunities in the economic landscape. This evolution underscores the dynamic nature of financial inclusion and the need for ongoing research and policy adjustments to ensure its effectiveness in promoting economic development.

Hamid et al. (2024) focused on the nexus between good governance and financial sustainability in India's microfinance sector. Their objective was to address the issues of unavailability of credit and high prices in rural communities. Using empirical analysis, the study concluded that good governance plays a crucial role in enhancing the financial sustainability of microfinance institutions (MFIs). The findings revealed

that governance practices such as transparency, accountability, and effective management significantly impact the availability and affordability of credit in rural areas. By fostering good governance, MFIs can improve their operational efficiency, build trust among stakeholders, and ensure long-term financial sustainability. This study highlights the critical role of governance in overcoming financial challenges and supporting the broader goals of financial inclusion and economic development.

Vichore and Rajput (2024) conducted a study on the evolution of the regulatory framework in India's microfinance sector. Their research sought to understand how financial regulatory frameworks adapt to changing economic and political environments. The methodology involved an analysis of regulatory requirements, and the findings discussed the challenges posed by political and regulatory leaders. The study revealed that regulatory frameworks need to be flexible and responsive to the dynamic nature of the microfinance sector. Political influences and regulatory hurdles often complicate the implementation of effective regulations, impacting the stability and growth of MFIs. By addressing these challenges, policymakers can create a more conducive regulatory environment that supports the sustainable development of the microfinance sector.

Uddin et al. (2024) examined the implications of microfinance governance for social inequality and poverty reduction. Their goal was to explore the challenges faced by microfinance institutions in addressing social inequalities and reducing poverty. The study utilized publications from the Microcredit Regulatory Authority and found that effective governance is essential for the financial sustainability and empowerment capabilities of MFIs. The results emphasized that good governance practices not only enhance the financial performance of MFIs but also their ability to contribute to social goals. By implementing strong governance frameworks, MFIs can better serve disadvantaged populations, reduce social inequalities, and promote inclusive economic growth.

Sangwan et al. (2023) conducted an analysis of regulatory non-compliances in microfinance operations with the objective of understanding the challenges associated with regulation and supervision in Indian MFIs. Utilizing a survey methodology, the study captured the MFIs' orientation towards financial regulation and compliance

issues. The findings highlighted significant gaps in the existing regulatory frameworks, underscoring the need for better regulatory structures to enhance MFI performance. Sangwan et al. pointed out that effective regulation is crucial for maintaining the integrity and stability of the microfinance sector. Improved regulatory frameworks could help MFIs navigate compliance challenges, thereby enhancing their operational efficiency and overall performance.

Adbi (2023) examined the financial sustainability of microfinance organizations in the aftermath of a scandal. The study aimed to assess the impact of such scandals on both for-profit and non-profit microfinance organizations. Through a comparative analysis, the research revealed that regulatory actions are essential in maintaining the sector's integrity and financial sustainability. The findings suggested that scandals significantly affect stakeholder trust and the financial health of MFIs, highlighting the importance of stringent regulatory oversight and prompt corrective actions. By ensuring transparency and accountability, regulatory bodies can help restore confidence and stability in the microfinance sector.

Kosasia and Njeru (2023) investigated the relationship between credit risk and profitability of Kenyan MFIs. The study aimed to address the challenges faced by the sector and ensure compliance with regulatory standards. Using descriptive statistics to present key financial indicators, the research highlighted the critical role of government intervention in mitigating credit risk and enhancing profitability. The findings indicated that effective credit risk management is essential for the financial health of MFIs. Government policies and regulatory frameworks that support robust credit risk assessment and management practices can significantly improve the profitability and sustainability of MFIs.

Durango-Gutiérrez et al. (2023) focused on default risk analysis under the Basel MPI framework, aiming to aid financial analysts, regulatory institutions, and policymakers in understanding microcredit risks. The study provided a detailed analysis of default risk, suggesting that borrowers with no financial problems have a lower probability of default (PD). The research emphasized the importance of adopting Basel MPI principles to enhance risk management practices in MFIs. By implementing stringent risk assessment and mitigation strategies, MFIs can better manage default risks,

thereby ensuring financial stability and protecting their portfolios from potential losses.

Lamichhane et al. (2023) conducted an analysis of the challenges and prospects of the Nepalese microfinance program. Their study aimed to assess the current state of microfinance and its effectiveness in reaching rural populations, who are often the primary beneficiaries of microfinance services. Using a mini review of existing literature, they identified several critical challenges faced by the sector, including inadequate regulatory support and limited government involvement. The findings suggest that for microfinance programs to be more effective in rural areas, there needs to be an enhanced role of government and regulatory institutions. This increased involvement could facilitate better governance, provide necessary infrastructure, and ensure that microfinance services are accessible and beneficial to the underserved populations.

Gautam (2023) explored the evolution of microfinance in Nepal and its relevance in contemporary financial inclusion efforts. The research aimed to analyze the challenges faced by microfinance institutions, particularly regarding high-interest rates and the need for product diversification. Through a comprehensive literature review, Gautam highlighted that while microfinance has made significant strides in promoting financial inclusion, several hurdles remain. The findings underscore the importance of microfinance in providing financial services to the unbanked population in Nepal. However, to sustain this momentum, MFIs must innovate and diversify their product offerings to meet the diverse needs of their clients. Addressing the issue of high-interest rates is also crucial to prevent over-indebtedness and ensure that financial services remain affordable for low-income individuals.

Singh et al. (2023) conducted a comparative analysis of the financial performance of microfinance institutions in Nepal before and after mergers. This study aimed to determine whether mergers lead to improved financial performance, which is critical for the sustainability of MFIs. Using statistical analysis of financial data, the study found that post-merger, MFIs exhibited significant improvements in their financial performance. These improvements were manifested in better financial health, increased profitability, and enhanced operational efficiencies. The findings suggest

that strategic mergers can be a viable option for MFIs struggling with performance issues, as they allow institutions to pool resources, reduce operational costs, and expand their reach.

Lamichhane and Bhaumik (2023) focused on the sustainability of Nepalese microfinance institutions, examining the factors that contribute to their long-term viability. Their study analyzed the financial services provided by MFIs as well as their social business aspects. The findings indicated that sustainability is influenced by a combination of sound financial practices and strong social performance. The study emphasized that for MFIs to be sustainable, they need to balance their financial objectives with their social missions. The applicability of these results extends to various financial institutions and regulatory authorities, suggesting that a holistic approach to regulation and support can enhance the sustainability of MFIs.

Chaulagain and Lamichhane (2022) conducted an in-depth analysis of the determinants of microfinance performance in Nepal, focusing particularly on the regulatory framework's impact. Their study utilized a comprehensive review of financial services provided to low-income individuals and households, highlighting the crucial role of regulation in shaping MFI performance. They found that a well-structured regulatory framework significantly contributes to the efficiency and sustainability of microfinance operations. By ensuring transparency, accountability, and prudent risk management, regulations help MFIs to maintain financial health and serve their target demographics effectively. The findings of Chaulagain and Lamichhane underscore the necessity of continuous regulatory updates and enforcement to address evolving challenges and enhance the sector's robustness.

Miled (2022) examined in the literature for its ability to reduce poverty from both a theoretical and empirical perspective. For this reason, we used panel data for 2005 and 2011 as well as cross-country data for 2011 to concentrate on the idea that microfinance lowers poverty. Our econometric findings constantly show that the ratio of the poverty head count to the per capita microfinance loan is strongly and negatively correlated with it, whereas the consumer expenditure is favourably and significantly correlated with it. In fact, after adjusting for the effects of other influencing factors, a nation with a higher gross loan portfolio per capita of MFIs

tends to have lower rates of poverty and higher consumption expenditures. The GDP per capita, the percentage of credit in GDP as a gauge of an economy's financial growth, international openness, and the inflation rate of US dollars are other elements that help reduce poverty.

Hossen, Miah, and Ruhi (2019) examined the deliberate actions of national governments, non-governmental organisations (NGOs), and donors who see microfinance as a useful tool for ending poverty have also contributed to the consistent growth of the micro finance concerned parties. The descriptive analysis based on secondary data was employed in the study. According to the study, microfinance has gained widespread acceptance as a means of eradicating poverty in underdeveloped nations like Bangladesh. It was determined that microfinance has a significant influence in reducing poverty. According to the report, in order for microfinance institutions to play a bigger part in reducing poverty, they need adopt appropriate policies and practices and advice borrowers to use their loans appropriately.

Risal (2018) examined the indebtedness and the state of microfinance institutions in Nepal. The population data was analysed and interpreted using the descriptive analytical research design, which was employed in this study. The study discovered that there are differences in the microloan services provided by different microfinance organisations. According to the study's findings, microfinance is a new type of organisation that operates globally primarily with the goal of eradicating poverty. The study suggested that in order for microfinance institutions to continue providing microfinance services and achieving their goal of reducing poverty, they should develop policies, strategies, and a regulatory framework that sets a benchmark for the amount of debt that can be incurred.

Kayastha (2013) examined the current issues facing the microfinance sector in Nepal, emphasizing legislative and regulatory challenges. Through a qualitative approach, the study delved into the complexities arising from the joint collaborations between foreign banks and Nepalese organizations. Kayastha highlighted several pressing issues, including inadequate regulatory measures for small-scale MFIs, which often operate with limited resources and face substantial operational hurdles. The study called for extended and more nuanced regulatory frameworks that accommodate the

unique needs of smaller providers. By doing so, these institutions can achieve better compliance and improve their service delivery, ultimately contributing to the broader financial inclusion agenda.

Adhikari and Shrestha (2013) evaluated the economic impact of microfinance in Nepal, with a particular focus on Manamaiju VDC. They found that women's economic status had increased as a result of their income-generating activities and that the microfinance programme had strengthened their sense of social empowerment. Both qualitative and quantitative methods were used in the study's data analysis. According to the survey, they had a better social-economic standing than people who did not have loans. The study came to the conclusion that microcredit is a useful instrument for improving the socioeconomic standing of the underprivileged, especially women. According to the survey, the loaners were requesting that the loan amount be increased; efficient methods for identifying the underprivileged and focusing loans on them should be created; training should be given; and frequent follow-up should be carried out.

Tilakaratna (2012) examined the characteristics and dynamics of client ship, paying particular attention to multiple client ship. The study made use of the explanation of the field research locations chosen and the rationale behind the choices. According to the survey, there is variation among MFI clients in terms of the types and quantities of financial services they use. The study came to the conclusion that this chapter's empirical evidence demonstrates a notably high degree of financial institution outreach in Sri Lanka, along with a notable degree of multiple client ship in the industry. The study suggested that there should be an increasing convergence in the country's regions and income categories' access to financial services.

Dhakal (2007) discussed emerging issues within the Nepalese microfinance sector. His evaluation of the effectiveness of microfinance services revealed significant gaps and areas for improvement. Dhakal emphasized the importance of establishing a supportive policy environment that fosters the growth and development of MFIs. He argued that a robust regulatory framework is essential to protect the interests of both the institutions and their clients, ensuring that microfinance services remain accessible, affordable, and reliable. This study suggested that future policy directions

should focus on creating an enabling environment that encourages innovation and sustainable growth within the microfinance sector.

**Table 1**

*Summary of Empirical Review*

Here's the table summarizing the recent studies on microfinance and financial inclusion:

S.N.	Authors (Date)	Objectives	Methodology	Findings
1	Udijanto et al. (2024)	Analyze financial inclusion strategies and their evolution	Historical analysis	Importance of adapting financial inclusion strategies to changing economic conditions
2	Hamid et al. (2024)	Explore the link between governance and financial sustainability in microfinance	Empirical analysis	Good governance is key to the financial sustainability of MFIs and credit availability
3	Vichore and Rajput (2024)	Study the evolution of the regulatory framework in India's microfinance sector	Analysis of regulatory requirements	Need for flexible and responsive regulatory frameworks due to political and economic changes
4	Uddin et al. (2024)	Examine microfinance governance implications for	Review of Microcredit Regulatory Authority	Effective governance enhances MFIs' financial performance and their role in

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		social inequality and poverty reduction	publications	reducing social inequalities
5	Sangwan et al. (2023)	Analyze regulatory non-compliances in Indian MFIs	Survey	Significant gaps in regulatory frameworks; need for better structures to enhance MFI performance
6	Adbi (2023)	Examine financial sustainability post-scandal	Comparative analysis	Scandals affect trust and financial health; importance of regulatory oversight
7	Kosasia and Njeru (2023)	Investigate credit risk-profitability relationship	Descriptive statistics	Government intervention critical in credit risk mitigation and profitability enhancement
8	Durango-Gutiérrez et al. (2023)	Analyze default risk under Basel MPI	Detailed analysis	Lower PD for borrowers with no financial problems; importance of Basel MPI adoption
9	Lamichhane et al. (2023)	Assess challenges and prospects of Nepalese microfinance	Mini literature review	Inadequate regulatory support; need for enhanced government role
10	Gautam	Explore microfinance	Literature	Microfinance promotes financial

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	(2023)	evolution and review financial inclusion in Nepal		inclusion; challenges include high-interest rates and need for diversification
11	Singh et al. (2023)	Compare financial performance pre- and post-mergers	Statistical analysis	Mergers lead to improved financial performance and operational efficiencies
12	Lamichhane and Bhaumik (2023)	Examine sustainability factors of Nepalese MFIs	Analysis of financial and social aspects	Sustainability influenced by financial practices and social performance
13	Chaulagain and Lamichhane (2022)	Analyze determinants of microfinance performance	Comprehensive review	Well-structured regulatory framework contributes to efficiency and sustainability
14	Miled (2022)	Examine microfinance's impact on poverty reduction	Panel and cross- country data analysis	Strong negative correlation between poverty head count ratio and per capita microfinance loan; positive correlation with consumer expenditure
15	Hossen, Miah, and Ruhi (2019)	Assess microfinance's role in poverty	Descriptive analysis based on secondary	Microfinance significantly reduces poverty; importance

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		eradication	data	of appropriate policies and loan usage
16	Risal (2018)	Analyze indebtedness and state of MFIs in Nepal	Descriptive analytical research	Differences in microloan services; need for policies and regulatory framework to manage debt
17	Kayastha (2013)	Address legislative and regulatory challenges in Nepal's microfinance sector	Qualitative approach	Inadequate measures for small-scale MFIs; need for nuanced regulatory frameworks
18	Adhikari and Shrestha (2013)	Evaluate economic impact of microfinance in Manamaiju VDC, Nepal	Mixed methods	Microfinance improves socioeconomic status, especially for women; suggestions for loan amount increase and targeted support
19	Tilakaratna (2012)	Study client ship dynamics in Sri Lanka	Field research	High financial institution outreach and multiple client ship; need for increased access to financial services
20	Dhakal (2007)	Discuss emerging issues	Evaluation of service	Significant gaps in services; importance

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in Nepalese effectiveness microfinance sector	of supportive policy environment and robust regulatory framework
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### **2.3 Research Gap**

Despite the extensive research on various aspects of microfinance institutions (MFIs), including regulatory frameworks, financial sustainability, governance, and risk management, a specific gap remains in understanding the direct relationship between compliance issues and the profitability of MFIs in Nepal. Studies such as those by Sangwan et al. (2023) and Kunjeda (2024) have highlighted the importance of regulatory compliance and capital adequacy in enhancing MFI performance and stability. However, there is a lack of focused research examining how specific compliance challenges directly impact the profitability of Nepalese MFIs. Additionally, while Adbi (2023) and Uddin et al. (2024) discuss the broader implications of governance and regulatory actions on financial sustainability and social inequality, there is limited empirical evidence linking compliance adherence to profitability metrics within the unique context of Nepal's microfinance sector. This research gap underscores the need for a detailed analysis that integrates compliance issues with profitability outcomes, providing actionable insights for policymakers and microfinance practitioners to enhance the sector's efficiency and impact.

## **CHAPTER-III**

### **RESEARCH METHODOLOGY**

There are various ways and methods utilized in research. To find the relationship between compliance issue of microfinance institution and profitability analysis, a quantitative approach was adopted. With the use of statistics, and other tools, this strategy seeks to fully solve an underlying task and analyses the outcomes. This chapter presents the general structure for the study, including data collection, presentation, and analysis, all of which contribute to achieving the study's goal. The examination of the framework and literature evaluation under progress.

#### **3.1 Research Design**

In this study, a descriptive and causal research design was employed. Descriptive and causal comparative research designs serve as the foundation for this investigation. While a causal comparative research strategy was employed to gather data regarding respondents' opinions and thoughts regarding the microfinance, their issues, their participation, etc., a descriptive research design was utilized to analyses qualitative information about the subject field.

Considering the purpose and requirements of this research, the research designs employed are: Descriptive research design: To describe existing or past phenomena and answer the previously constructed research questions. Causal research design: To analyse the association between dependent and independent variables.

#### **3.2 Population and Sample**

The opinion of employees regarding loan lending systems, management systems, effective risk management, and regulatory framework to find determinants of microfinance performance in Nepal. The entire population of this research was the employee of microfinance was the sampling universe. In this study, the working members of the microfinance company in Kathmandu valley. Convenience sampling, a non-probability sampling method, was implemented as the only online medium used for data collection. Similarly, out of 412 questionnaires issued, 400 sample responses were successfully collected.

### **3.3 Nature and Sources of Data**

This research is completely reliant on the primary data. As a primary data collection tool, the online questionnaire method was conducted online via Google Forms among the microfinance employee in the Kathmandu metropolitan, Nepal. The demographic profiles of the respondents and their respective perceptions and microfinance employee overview were recorded.

### **3.4 Data Collection and Processing Procedure**

The study was based on primary sources of data. The primary sources of data were used for the quantitative research. The primary data was used to extract the information from the employees regarding relationship between compliance issue of microfinance institution and profitability analysis. The structural questionnaire was designed to collect information on relationship between compliance issue of microfinance institution and profitability analysis. First part of questionnaires was dealing with the demographic information such as gender, age, education, and monthly income. Similarly, second part of the questionnaire was designed to relationship between compliance issue of microfinance institution and profitability analysis. There is 4-5 statement that characterizes each relationship between compliance issue of microfinance institution and profitability analysis. Each statement is measured on Likert scale. 5 point Likert scale have been used for the survey of which 5= strongly agree and 1= strongly disagree. The questionnaire in second part consists of various statements of the loan lending systems, management systems, effective risk management, and regulatory framework. These variables were used to determine relationship between compliance issue of microfinance institution and profitability analysis.

For the data analysis, SPSS tool was used to tabulate and analyze the valid responses. In the beginning, comprehensive data file was created. Then, variable and their labels were defined as well as its values are inserted. Data were entered using user-friendly menu of SPSS operated commands. Different statistical tools such as frequencies, percentage, and mean, median, standard deviation, compare mean t-test, correlation and regression was used in this study to measure relationship between compliance issue of microfinance institution and profitability analysis. Microsoft excel sheet was also used for the calculation of the average scores and used for the data collection procedure and tables as required.

### **3.5 Methods of Analysis**

The paper will mostly use primary data in order to meet the goal. Descriptive statistics and causal comparative has been used to analyse the data that has been obtained. Two ordinary least square models has been used in the empirical study to provide a thorough examination of the impact of microfinance on reducing poverty in the Kathmandu valley.

The methods of data analysis have many sections. First section is primary data analysis which includes summary of descriptive statistics associated with general information of respondents like age, gender, education and monthly income.

Second section analyzes the descriptive statistics such as mean and weighted average values of four influencing factors i.e. lending systems, management systems, effective risk management, and regulatory framework. The study also uses percentage frequency distribution and mean-scores of the responses to Likert scale items. Third section deals with the Pearson's correlation analysis to study the relation between different variables. Similarly, fourth sections deal with the regression analysis of primary data. Regression model applied to estimate the relationship between dependent variable with independent variable. The collected data was analyzed with the help of SPSS.

Total responses collected from the respondents was coded and tabulated into SPSS worksheet. The function of SPSS is to analyze the result of the questionnaire and then helps to interpret the findings. The various tools such as frequencies, descriptive statistics, and casual comparative and reliability analysis (Cronbach's alpha) applied to derive the result. Further, p-value was used to check the level of significance of the different statements.

### **3.6 Research Framework and Definition of Variables**

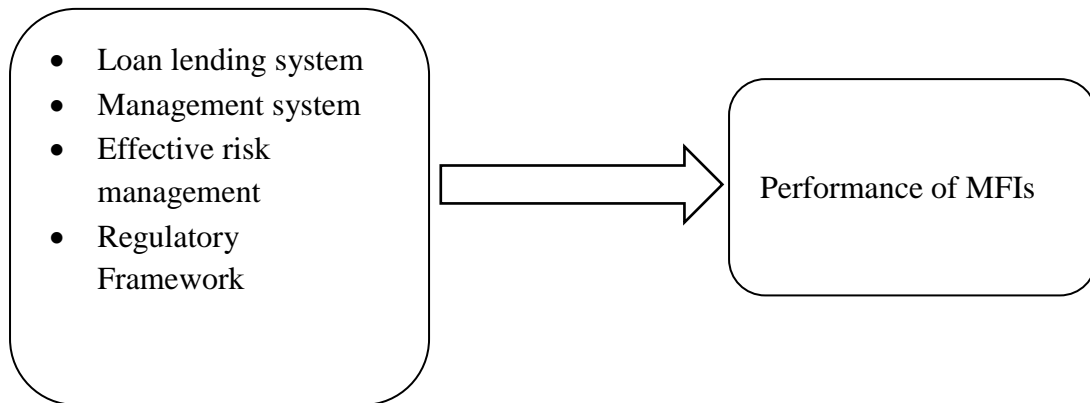
A conceptual framework has been constructed to comprehend the impact of microfinance institutions. This framework is depicted in Figure below. This was created using the results of a preliminary examination of the literature on the relationship between compliance issue of microfinance institution and profitability analysis. The lending systems, management systems, effective risk management, and regulatory framework make up the four main components of the conceptual framework. Figure 1 is a diagrammatic representation of the framework that shows

the suggested linkages and mediating elements examined in this thesis, taking into account the understanding of performance of microfinance in this study.

### **Independent Variables**

#### **Variables**

### **Dependent**



*Figure 1* Research Framework

*Source: Chaulagain and Lamichhane (2022)*

### **3.6.1 Definition of Variables**

#### **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).

#### **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).

#### **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.

### **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).

### **Performance of MFIs**

The performance of microfinance institutions (MFIs) is a multifaceted concept that encompasses various dimensions such as financial sustainability, outreach, impact on poverty alleviation, and client satisfaction. Assessing the performance of MFIs requires careful consideration of both financial and social indicators to provide a comprehensive understanding of their effectiveness in achieving their mission and objectives. Asset quality indicators, such as the portfolio-at-risk (PAR) ratio and write-off rates, reflect the quality of the loan portfolio and the institution's ability to manage credit risk. Efficiency ratios, such as the operating expense ratio and the cost

per borrower, evaluate the MFI's operational efficiency and cost-effectiveness (Leonard, 2016).

## CHAPTER IV

### RESULTS AND DISCUSSION

Through an empirical analysis of the information gathered from the respondents, this chapter seeks to accomplish the study's goals. The goal of this chapter is to summarize the findings from the study technique and data analysis covered in chapter three. Based on the research questions and hypotheses, the data results are analyzed. On the basis of primary data obtained from the 400 respondents, the study tried to examine relationship between compliance issue of microfinance institution and profitability analysis. This chapter includes the demographic profile of respondents, descriptive statistics of variables and testing of hypothesis and discussion of the result obtained through analysis. Respondent's profile summarized basic information such as gender, educational level, age etc. Under the analysis mean value, standard deviations, correlation and regression of corresponding items of the research variables are analyzed. Finally, hypothesis is discussed in order to meet the objectives of the study. The data are presented with tables to make it convenient to interpret.

#### 4.1 Demographic Profile of Respondents

The demographic analysis and interpretation of the gathered data are covered in this section. A total of 400 participants were chosen for the study, and each participant works for a bank. This section includes a demographic profile that includes information about age, gender, education level, and annual income. The respondent's demographic profile is displayed in the table.

##### 4.1.1 Gender of Respondents

The gender of respondents is classified into male, female and others. The frequency distribution and percentage composition of different genders is shown in Table 2.

**Table 2**

*Gender of respondent*

Gender of respondents	Frequency	Percent
Male	246	61.5
Female	154	38.5
Total	400	100.0

Table 2 shows the gender distribution of respondents of the study. Among the 400 total respondents, 246 individuals identified as male, comprising 61.5% of the total sample, while 154 respondents identified as female, making up the remaining 38.5%. This gender breakdown provides important demographic information about the study's participants and highlights the gender diversity within the sample.

#### 4.1.2 Age of Respondents

The Age of respondents is classified into below 20, 21-30, 31-40 and above 40. The frequency distribution and percentage composition of different genders is shown in Table 3.

**Table 3**

*Age of respondents*

Age of respondents	Frequency	Percent
20-30	64	16.0
31-40	197	49.3
41-50	85	21.3
50 & above	54	13.5
Total	400	100.0

Table 3 provides an overview of the age distribution among the surveyed respondents. Out of the total 400 respondents, the majority fall within the age range of 31 to 40, with 197 individuals representing 49.3% of the sample. The next most populous age group is 41 to 50, which comprises 21.3% of the respondents, followed by the 20 to 30 age group at 16.0%. Lastly, there are 54 respondents aged 50 and above, making up 13.5% of the total sample.

#### 4.1.3 Education Status of Respondents

The education status of respondents is classified Bachelor's degree, Doctoral degree, High school and Master's degree. The frequency distribution and percentage composition of different education level of respondents is shown in Table 3.

**Table 4***Education Level*

Education Level	Frequency	Percent
Bachelor's degree	227	56.8
Doctoral degree	54	13.5
High school	21	5.3
Master's degree	98	24.5
Total	400	100.0

Table 4 presents the educational backgrounds of the surveyed respondents, offering insights into their levels of education. Among the 400 total respondents, the largest group holds a Bachelor's degree, with 227 individuals, representing 56.8% of the sample. The next most common educational attainment is a Master's degree, comprising 24.5% of the respondents, followed by individuals with Doctoral degrees at 13.5%. A smaller portion of the sample, 5.3%, has a High School education.

**4.1.4 Annual Income**

The annual income is classified into 0-100,000, 100,000-300,000, 300,000-600,000 and 600,000 and above. The frequency distribution and percentage composition of annual income of respondents is shown in Table 5.

**Table 5***Annual Income*

	Frequency	Percent
0-100,000	21	5.3
100,000-300,000	168	42.0
300,000-600,000	141	35.3
600,000 and above	70	17.5
Total	400	100.0

Table 5 presents data on the annual income levels of respondents before their involvement in a microfinance program. Out of the total 400 respondents, the most significant portion falls within the income range of 100,000 to 300,000, with 168

individuals, accounting for 42.0% of the sample. The next most common income category is 300,000 to 600,000, encompassing 35.3% of the respondents. A smaller percentage of individuals, 17.5%, reported annual incomes of 600,000 and above. Lastly, 5.3% of the respondents reported annual incomes within the 0 to 100,000 range.

## 4.2 Descriptive Statistics

This part of research explains the descriptive analysis of the data collected from the respondents through the questionnaires during the research process. Descriptive analysis explains the data with the help of statistical tools and measures. Those statistical measures are mean, frequency and standard deviation. This mean and standard deviation are presented in the tabular form. For this study “Five Point Likert Scale” questions were asked to bank employees which scaled from:

1- Strongly Disagree

2- Disagree

3- Neutral

4- Agree

5- Strongly Agree

### 4.2.1 Mean and standard deviation of all variables

The mean and standard deviation of independent and dependent variables are shown in Table 6.

**Table 6**

*Descriptive Statistics*

	Minimum	Maximum	Mean	Std. Deviation
LLS	1.00	5.00	3.4195	1.09403
MS	1.00	5.00	3.4515	1.16208
ERM	1.00	5.00	3.3970	1.22284
RF	1.00	5.00	3.4035	1.15587
MP	1.00	5.00	3.1925	1.24141

Table 6 presents descriptive statistics for various factors related to the performance of microfinance institutions (MFIs), with MP representing the performance of MFIs as the dependent variable. The table provides key summary statistics, including the minimum, maximum, mean, and standard deviation, for each variable: Loan Lending System (LLS), Management System (MS), Effective Risk Management (ERM), Regulatory Framework (RF), and the dependent variable MP.

The variable LLS, representing the Loan Lending System, ranges from a minimum value of 1.00 to a maximum value of 5.00, with a mean of 3.4195 and a standard deviation of 1.09403. This indicates that the loan lending systems of the MFIs in the study exhibit variability in their effectiveness, with the majority falling around the mean value.

Similarly, the Management System (MS) variable ranges from 1.00 to 5.00, with a mean of 3.4515 and a standard deviation of 1.16208. This suggests that the management systems of the MFIs vary in their efficiency and effectiveness, with some institutions performing above or below the mean.

The Effective Risk Management (ERM) variable also shows variability, with values ranging from 1.00 to 5.00. The mean is calculated at 3.3970, with a standard deviation of 1.22284. This indicates differences in the effectiveness of risk management practices among the MFIs included in the study.

Similarly, the Regulatory Framework (RF) variable ranges from 1.00 to 5.00, with a mean of 3.4035 and a standard deviation of 1.15587. This suggests variations in the regulatory environments in which the MFIs operate, impacting their performance outcomes.

Finally, the dependent variable MP, representing the performance of MFIs, ranges from 1.00 to 5.00, with a mean of 3.1925 and a standard deviation of 1.24141. This indicates that the performance of MFIs, as measured in the study, exhibits variability, with some institutions performing better or worse than others on average.

### **4.3 Inferential analysis**

This section's goal is to outline the methodology for evaluating the empirical data and testing the hypotheses developed in the preceding chapter. Through the application of inferential statistics, researchers can draw conclusions or extrapolate findings from sample data to the entire population. It makes it possible to infer population values

from one or more observational samples. To ascertain whether observed differences between groups or variables are true or the result of random variation, inferential analysis tests hypotheses. It generates new data by extrapolating generalizations and predictions from samples. There are two analytic tools in this section, which are:

#### 4.3.1 Correlation analysis

To determine the relationships between the variables, correlation analysis was examined. The relationship between the many independent and dependent variables related to the research is ascertained using Pearson's Correlation analysis. Any two variables' linear correlation is measured.

**Table 7**

*Correlations*

	MP	LLS	MS	ERM	RF
MP	1				
LLS	.789**	1			
MS	.793**	.912**	1		
ERM	.823**	.924**	.938**	1	
RF	.814**	.913**	.932**	.933**	1

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

Table 7 presents the correlation matrix for the variables included in the study, including the dependent variable MP (Performance of MFIs) and independent variables: Loan Lending System (LLS), Management System (MS), Effective Risk Management (ERM), and Regulatory Framework (RF). Correlation coefficients measure the strength and direction of the linear relationship between pairs of variables, ranging from -1 to 1.

The correlation coefficient between MP and LLS is 0.789, which indicates a strong positive relationship between the Performance of MFIs (MP) and the Loan Lending

System (LLS). This suggests that MFIs with more effective loan lending systems tend to have higher performance ratings.

Similarly, the correlation coefficient between MP and MS is 0.793, indicating a strong positive relationship between the Performance of MFIs (MP) and the Management System (MS). This suggests that MFIs with more efficient and effective management systems tend to perform better overall.

The correlation coefficient between MP and ERM is 0.823, indicating a strong positive relationship between the Performance of MFIs (MP) and Effective Risk Management (ERM). This suggests that MFIs with better risk management practices tend to have higher performance ratings.

Additionally, the correlation coefficient between MP and RF is 0.814, indicating a strong positive relationship between the Performance of MFIs (MP) and Regulatory Framework (RF). This suggests that MFIs operating within more supportive regulatory environments tend to perform better overall.

#### **4.3.2 Regression Analysis**

Regression analysis makes the assumption that there is a causal link between two or more variables, whereas correlation analysis makes no such assumption. The effects of one independent variable on one dependent variable are displayed by simple linear regression, but the effects of several independent factors on one dependent variable are displayed by multiple linear regression. The degree of association between two variables is all that correlation analysis can reveal. Regression analysis is therefore performed in order to gain a deeper comprehension of the degree of correlation between two or more variables. The impact of several independent factors on a single dependent variable is examined using multiple regression analysis. Consequently, the impact of numerous independent variables on microfinance institutions profitability analysis is examined using multiple regression analysis. The statistical multiple regression model was created using the suggested research model and went like this:

$$MP = \beta_0 + \beta_1 LLS + \beta_2 MS + \beta_3 ERM + \beta_4 RF + \epsilon_i \dots \dots \dots (1)$$

Where,

$\alpha_1$  = Constant Intercept of the Regression and  $\beta_1, \beta_2, \beta_3, \beta_4$  and  $\beta_5$  are the coefficient of regression

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

LLS = Loan Lending System

MS = Management System

ERM = Effective Risk Management &

RF = Regulatory Framework as an independent variable.

$e_i$  = Error term

The following tables show the findings from the model summary, analysis of variance (ANOVA), and beta coefficients of the impact of independent factors on the contribution of microfinance institution and profitability analysis.

**Table 8**

*Model Summary*

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.842 <sup>a</sup>	.709	.705	.59714

a. Predictors: (Constant), MS, LLS, RF, ERM

R Square, measures the proportion of the variance in the dependent variable (MP) that can be explained by the predictors in the model. In this case,  $R^2$  is approximately 0.709, suggesting that roughly 70.9% of the variability in income can be accounted for by the combination of the included predictors. The Adjusted R Square value, adjusted for the number of predictors in the model, provides a more conservative estimate of the proportion of variance explained. It helps prevent overfitting. Here, the Adjusted R Square is approximately 0.705, indicating that even after adjusting for the number of predictors, the model still explains about 70.5% of the variance in income.

**Table 9***ANOVA*

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	342.247	5	68.449	191.963	.000 <sup>b</sup>
	Residual	140.491	394	.357		
	Total	482.737	399			

a. Dependent Variable: MP

b. Predictors: (Constant), MS, LLS, RF, ERM

The ANOVA table helps assess the overall significance of the regression model. In this case, the low p-value (Sig. = .000) associated with the F statistic indicates that the model is highly significant, suggesting that at least one of the predictors ( MS, LLS, RF, ERM) significantly contributes to explaining the variance in Performance of MFIs (MP).

**Table 10***Coefficient*

Model		Unstandardized Coefficients			Sig.
		B	Std. Error	t	
1	(Constant)	.711	.101	7.066	.000
	LLS	-.021	.082	-.251	.802
	MS	.023	.085	.266	.790
	ERM	.343	.086	3.966	.000
	RF	.225	.086	2.621	.009

a. Dependent Variable: MP

Table 10 presents the coefficients from a regression model where the dependent variable is the Performance of MFIs (MP), and the independent variables are Loan

Lending System (LLS), Management System (MS), Effective Risk Management (ERM), and Regulatory Framework (RF). The coefficients indicate the estimated effect of each independent variable on the dependent variable, holding other variables constant.

The constant term (Constant) has a coefficient of 0.711 and a standard error of 0.101. The t-value of 7.066 indicates that the constant term is statistically significant at the 0.01 level, suggesting that even when all independent variables are zero, there is a significant positive impact on the Performance of MFIs (MP).

For the independent variables, the coefficient for LLS is -0.021, with a standard error of 0.082 and a t-value of -0.251. However, the significance level (Sig.) of 0.802 suggests that the coefficient for LLS is not statistically significant, indicating that the Loan Lending System does not have a significant effect on the Performance of MFIs (MP) in this model.

Similarly, the coefficients for MS and RF are 0.023 and 0.225, respectively. Both coefficients have t-values of 0.266 and 2.621, but their significance levels are 0.790 and 0.009, respectively. The coefficient for MS is not statistically significant, while the coefficient for RF is statistically significant at the 0.01 level, suggesting that the Regulatory Framework has a significant positive effect on the Performance of MFIs (MP).

The coefficient for ERM is 0.343, with a standard error of 0.086 and a t-value of 3.966. The significance level of 0.000 indicates that the coefficient for ERM is statistically significant at the 0.01 level, suggesting that Effective Risk Management has a significant positive effect on the Performance of MFIs (MP).

## **4.2 Discussion**

The results shows that the significant positive effect of Effective Risk Management (ERM) on the Performance of MFIs (MP). This finding resonates with previous research emphasizing the importance of risk management practices in enhancing the financial stability and sustainability of microfinance institutions (Udijanto et al., 2024; Hamid et al., 2024). Effective risk management not only mitigates potential losses but also enhances investor confidence and fosters long-term viability.

Similarly, the regression results indicate a significant positive effect of the Regulatory Framework (RF) on MFI performance. This underscores the crucial role of supportive regulatory environments in fostering a conducive operating environment for MFIs (Vichore & Rajput, 2024). Flexible and responsive regulatory frameworks are essential for balancing consumer protection, financial inclusion goals, and institutional sustainability. On the other hand, the regression analysis reveals that neither the Loan Lending System (LLS) nor the Management System (MS) exhibits a statistically significant effect on MFI performance. This finding raises questions about the effectiveness of current loan processing and management practices within MFIs. Further research may be warranted to identify opportunities for enhancing operational efficiency and effectiveness in these areas (Gautam, 2023; Dhakal, 2007).

The increasing commercialization of MFIs, as evidenced by the emergence of commercial microfinance institutions seeking profit maximization, signifies a paradigm shift in the microfinance landscape (Ghalib et al., 2015). While profit orientation may enhance self-sustainability and attract investors, it also underscores the evolving nature of microfinance institutions and their adaptation to changing market dynamics. Given Nepal's status as one of the poorest nations in South Asia, the findings underscore the imperative for robust policy interventions aimed at poverty alleviation and inclusive economic development (Risal, 2018; Adhikari & Shrestha, 2013). Effective governance, supportive regulatory frameworks, and targeted poverty reduction strategies are essential for harnessing the potential of microfinance as a tool for socio-economic empowerment and poverty eradication.

## CHAPTER-V

### SUMMARY AND CONCLUSION

#### 5.1 Summary

The objective of this study is to analyze the effect of compliance issue of microfinance institution on the profitability analysis of Nepal. The descriptive statistics provide a foundational understanding of the distribution and variability of key variables, shedding light on the average performance level of MFIs in Nepal (MP) and the extent of variability within the sampled institutions. This insight suggests that while some MFIs may perform relatively well, there are others experiencing significant challenges or variations in performance, which could be attributed to a multitude of factors including operational inefficiencies, market dynamics, or regulatory constraints.

Moreover, the correlation analysis reveals intriguing patterns of association between MFI performance and operational components such as loan lending systems, management practices, risk management effectiveness, and regulatory frameworks. The significant positive correlations with effective risk management and regulatory compliance underscore the pivotal role of these factors in driving MFI profitability. Robust risk management practices not only mitigate potential losses but also enhance the institution's resilience to external shocks, thereby fostering long-term sustainability. Similarly, a supportive regulatory environment can facilitate MFI operations, ensuring compliance while providing an enabling framework for growth and innovation.

However, the lack of significant associations between MFI performance and factors like loan lending systems and management practices raises important questions about the efficacy of current approaches in these areas. While these findings do not necessarily imply that these aspects are inconsequential, they do suggest potential areas for improvement or optimization. For instance, enhancing loan lending systems to streamline processes, improve access to credit, or mitigate default risks could yield tangible benefits for MFI profitability. Likewise, strengthening management practices, such as strategic planning, human resource management, and performance monitoring, could enhance operational efficiency and effectiveness, ultimately contributing to improved financial performance.

In summary, addressing compliance issues within the microfinance sector requires a multifaceted approach that encompasses regulatory reforms, capacity building, and institutional innovation. Regulatory authorities need to ensure a balanced regulatory framework that fosters financial inclusion while safeguarding consumer interests and systemic stability. At the same time, MFIs must invest in robust risk management systems, operational excellence, and staff training to navigate regulatory complexities effectively and seize growth opportunities in a rapidly evolving landscape. By prioritizing compliance and operational excellence, MFIs can not only enhance their profitability but also fulfill their broader mission of promoting inclusive and sustainable development.

## **5.2 Conclusion**

In conclusion, the examination of compliance issues within microfinance institutions (MFIs) alongside profitability analysis unveils critical insights into the operational dynamics and performance drivers of MFIs in Nepal. The findings underscore the pivotal role of effective risk management and regulatory compliance in shaping MFI profitability, with significant positive correlations observed between these factors and MFI performance. Robust risk management practices and supportive regulatory frameworks emerge as key enablers of financial stability and sustainable growth within the microfinance sector. By embracing a culture of compliance and operational excellence, MFIs can not only enhance their financial performance but also advance their broader mission of empowering underserved communities and promoting inclusive economic development. Moving forward, collaboration between regulatory stakeholders, MFIs, and industry partners will be essential to foster a resilient and sustainable microfinance ecosystem in Nepal, driving positive social impact and economic empowerment at the grassroots level.

Expanding upon the conclusion, it's imperative to recognize the broader implications of addressing compliance issues within the microfinance sector, extending beyond mere financial metrics to encompass social and developmental outcomes. Microfinance institutions serve as vital engines of inclusive growth, providing access to financial services for marginalized and underserved populations, particularly in rural and remote areas where traditional banking infrastructure is limited. By strengthening regulatory frameworks and enhancing compliance standards,

policymakers can bolster consumer confidence, safeguarding vulnerable borrowers from predatory practices and ensuring fair and transparent financial services. Moreover, a well-regulated microfinance sector can contribute to broader economic stability by channeling capital to productive sectors, fostering entrepreneurship, and stimulating local economic development.

Furthermore, the pursuit of compliance and operational excellence aligns with global sustainability goals, including the United Nations Sustainable Development Goals (SDGs). Microfinance plays a pivotal role in advancing several SDGs, including poverty alleviation, gender equality, and decent work and economic growth. By promoting responsible finance practices and embedding environmental, social, and governance (ESG) considerations into their operations, MFIs can amplify their positive impact on society and contribute to the achievement of sustainable development objectives. In last, the journey towards addressing compliance issues within the microfinance sector is not merely a quest for regulatory adherence or financial performance but a transformative endeavor with profound socio-economic implications. By fostering a culture of compliance, innovation, and inclusive growth, stakeholders can unlock the full potential of microfinance as a catalyst for poverty reduction, economic empowerment, and sustainable development in Nepal and beyond.

### **5.3 Implications**

#### **Managerial Implications**

- MFIs should prioritize the enhancement of their risk management frameworks to mitigate potential losses, ensure financial stability, and improve overall performance.
- Developing and implementing strategies to ensure compliance with regulatory requirements is crucial. This may involve investing in staff training, updating policies and procedures, and leveraging technology for regulatory reporting and monitoring.
- Collaborating with regulatory authorities to advocate for supportive regulatory environments that balance consumer protection with financial inclusion goals can enhance operational flexibility and foster sustainable growth.

- Identifying and addressing inefficiencies in loan lending systems and management practices can lead to cost savings, improved service delivery, and enhanced customer satisfaction.
- Embracing digital financial services can streamline processes, expand outreach, and enhance operational efficiency. MFIs should explore opportunities to leverage technology to improve service delivery while mitigating associated risks.

### **Research Implications**

- Conducting longitudinal studies to track the impact of compliance initiatives and operational improvements on MFI performance over time can provide valuable insights into the sustainability and effectiveness of interventions.
- Exploring the qualitative aspects of compliance and operational challenges through interviews, focus groups, or case studies can offer a deeper understanding of the underlying factors influencing MFI performance and regulatory compliance.
- Comparing the compliance frameworks and performance outcomes of MFIs across different regions or countries can highlight best practices, regulatory variations, and contextual factors shaping MFI operations and outcomes.
- Investigating the impact of technological innovations, such as mobile banking and digital payments, on compliance, operational efficiency, and financial inclusion outcomes can uncover opportunities and challenges associated with digital transformation in the microfinance sector.
- Conducting rigorous social impact assessments to evaluate the contribution of MFIs to poverty reduction, gender equality, and other socio-economic development goals can provide a holistic understanding of their role in promoting inclusive growth and sustainable development.

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**Appendix–I**

**QUESTIONNAIRE**

**“Compliance issue of microfinance institution and profitability  
analysis”**

I am Laxman Giri, student of masters of Business Studies (MBS), Shanker Dev  
Campus. I am doing this survey as a partial fulfillment of requirement for the degree  
of MBS. I would be thankful if you fill this questionnaire.

**Questionnaire**

**Name:** .....

**Personal Information**

1. Which is your gender?

A. Male          B. Female    C. others

2. In which age range do you belong?

A. Below 20 years          B. 20-40 years          C. 40-60 years    E. 60 above

3. What is your level of education?

A. Below or SEE/SLC          B. Intermediate (+2)          C. Bachelor    D. Master  
or Above

5. Annual income

A. 0-100,000          B. 100,000-300,000    C. 300,000-600,000

D. 600,000 and above

<p><b>How do you agree with the following statement about your microfinance?</b></p> <p><input type="checkbox"/> Strongly Agree, <input type="checkbox"/> Agree, <input type="checkbox"/> Neutral, <input type="checkbox"/> Disagree, <input type="checkbox"/> Strongly Disagree</p>	
<p><b>Loan Lending System</b></p>	
<p>The loan application process in our microfinance institution is efficient and transparent.</p>	<p><input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/></p>
<p>Our loan terms and conditions are clearly communicated to borrowers.</p>	<p><input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/></p>
<p>The loan approval process is timely and responsive to borrower needs.</p>	<p><input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/></p>
<p>Our loan products are tailored to meet the diverse needs of our clients.</p>	<p><input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/></p>
<p>Overall, I am satisfied with the loan lending system in our microfinance institution.</p>	<p><input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/></p>
<p><b>Management System</b></p>	
<p>The leadership in our microfinance institution fosters a culture of transparency and accountability.</p>	<p><input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/></p>
<p>Decision-making processes are inclusive and involve input from staff at all levels.</p>	<p><input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/></p>
<p>There are clear channels for communication and feedback within our organization.</p>	<p><input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/></p>
<p>Training and development opportunities are provided to enhance staff skills and competencies.</p>	<p><input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/></p>
<p>Overall, I believe our management system effectively supports</p>	<p><input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/></p>

the goals and objectives of our microfinance institution.	
<b>Effective Risk Management</b>	
Our microfinance institution has robust systems in place to identify and assess potential risks.	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
Risk mitigation strategies are regularly reviewed and updated to address emerging threats.	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
Staff members are trained to recognize and respond to risk factors in their day-to-day operations.	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
We have contingency plans in place to mitigate the impact of unforeseen events on our operations.	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
Overall, I am confident in the effectiveness of our risk management practices.	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
<b>Regulatory Framework</b>	
Our microfinance institution complies with all relevant laws and regulations governing our operations.	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
We maintain open communication channels with regulatory authorities to ensure compliance.	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
Regulatory requirements are clearly communicated and understood by staff members.	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
Our institution proactively seeks opportunities to align with industry best practices and standards.	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
Overall, I believe our regulatory framework provides a solid foundation for our microfinance operations.	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
<b>Performance of Microfinance Institutions</b>	

<p>Our microfinance institution consistently meets or exceeds its financial targets and objectives.</p>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
<p>We have a strong reputation for delivering high-quality financial services to our clients.</p>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
<p>Customer satisfaction levels are regularly monitored and addressed to improve service delivery.</p>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
<p>Our institution actively contributes to the socio-economic development of communities we serve.</p>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
<p>Overall, I am confident in the performance and impact of our microfinance institution in Nepal.</p>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>

**.Appendix- II**

**gender**

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Female	246	61.5	61.5	61.5
	Male	154	38.5	38.5	100.0
	Total	400	100.0	100.0	

**age**

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	20-30	64	16.0	16.0	16.0
	31-40	197	49.3	49.3	65.3
	41-50	85	21.3	21.3	86.5
	50 & above	54	13.5	13.5	100.0
	Total	400	100.0	100.0	

**Educational level**

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Bachelor's degree	227	56.8	56.8	56.8
	Doctoral degree	54	13.5	13.5	70.3
	High school	21	5.3	5.3	75.5

Master's degree	98	24.5	24.5	100.0
Total	400	100.0	100.0	

### Annual income

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid 0-100,000	21	5.3	5.3	5.3
100,000-300,000	168	42.0	42.0	47.3
300,000-600,000	141	35.3	35.3	82.5
600,000 and above	70	17.5	17.5	100.0
Total	400	100.0	100.0	

### Correlations

		MP	LLS	MS	ERM	RF
MP	Pearson Correlation	1	.789**	.793**	.823**	.814**
	Sig. (2-tailed)		.000	.000	.000	.000
LLS	Pearson Correlation	.789**	1	.912**	.924**	.913**
	Sig. (2-tailed)	.000		.000	.000	.000
MS	Pearson Correlation	.793**	.912**	1	.938**	.932**
	Sig. (2-tailed)	.000	.000		.000	.000
ERM	Pearson Correlation	.823**	.924**	.938**	1	.933**

	Sig. (2-tailed)	.000	.000	.000		.000
RF	Pearson Correlation	.814**	.913**	.932**	.933**	1
	Sig. (2-tailed)	.000	.000	.000	.000	

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

### Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
LLS	400	1.00	5.00	3.4195	1.09403
MS	400	1.00	5.00	3.4515	1.16208
ERM	400	1.00	5.00	3.3970	1.22284
RF	400	1.00	5.00	3.4035	1.15587
MP	400	1.00	5.00	3.1925	1.24141
Valid N (listwise)	400				

### Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.842 <sup>a</sup>	.709	.705	.59714

a. Predictors: (Constant), MS, LLS, RF, ERM

**ANOVA<sup>a</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	342.247	5	68.449	191.963	.000 <sup>b</sup>
	Residual	140.491	394	.357		
	Total	482.737	399			

a. Dependent Variable: MP

b. Predictors: (Constant), MS, LLS, RF, ERM

**Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.711	.101		7.066	.000
	LLS	-.021	.082	-.020	-.251	.802
	MS	.023	.085	.024	.266	.790
	ERM	.343	.086	.381	3.966	.000
	RF	.225	.086	.237	2.621	.009

a. Dependent Variable: MP

# COMPLIANCE ISSUE OF MICROFINANCE INSTITUTION AN...

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**paper text:**

ABSTRACT The objective of this study is to analyze the effect of compliance issue of microfinance institution on the profitability analysis of Nepal. The descriptive statistics provide a foundational understanding of the distribution and variability of key variables, shedding light on the average performance level of MFIs in Nepal (MP) and the extent of variability within the sampled institutions. This insight suggests that while some MFIs may perform relatively well, there are others experiencing significant challenges or variations in performance, which could be attributed to a multitude of factors including operational inefficiencies, market dynamics, or regulatory constraints. Moreover, the correlation analysis reveals intriguing patterns of association between MFI performance and operational components such as loan lending systems, management practices, risk management effectiveness, and regulatory frameworks. The significant positive correlations with effective risk management and regulatory compliance underscore the pivotal role of these factors in driving MFI profitability. While these findings do not necessarily imply that these aspects are inconsequential, they do suggest potential areas for improvement or optimization. For instance, enhancing loan lending systems to streamline processes, improve access to credit, or mitigate default risks could yield tangible benefits for MFI profitability. Likewise, strengthening management practices, such as strategic planning, human resource management, and performance monitoring, could enhance operational efficiency and effectiveness, ultimately contributing to improved financial performance. Furthermore, By promoting responsible finance practices and embedding environmental, social, and governance (ESG) considerations into their operations, MFIs can amplify their positive impact on society and contribute to the achievement of sustainable development objectives. In last, the journey towards addressing compliance issues within the microfinance sector is not merely a quest for regulatory adherence or financial performance but a transformative endeavor with profound socio-economic implications. Keywords: Performance of