

## SME Financing Constraints: Evidence from Survey of Retail Firms in Nepal

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### Abstract

*Small and Medium Enterprises have a vital role to play in the development of the economy in Nepal, however, access to formal finance in particular to the retail sector has remained a persistent barrier. Small and Medium Enterprises are of utmost importance for Nepal's economic growth and are contributing to a great extent in job creation, and growth in GDP. However, access to sufficient financing is a significant constraint in the growth of SMEs particularly in the retail sector due to the application of traditional collateral requirements and complicated procedures in lending. This research is focused on the issue of financing constraints of retail SMEs in Nepal and its impact on business operation and growth prospects. Using the quantitative approach, total of 425 retail SME owners were surveyed in major urban centers of Nepal using structured questionnaire as a tool of data collection. Descriptive statistics and multiple regression analysis were used to examine the correlation between financing constraint (collateral requirement, interest rates, processing complexity of loan and information asymmetry) and business performance indicators (revenue growth, operational efficiency and capacity to expand). The results show that collateral requirements ( $B = -2.143, p < 0.01$ ) and processing complexity of loans ( $B = -1.892, p < 0.01$ ) have significant impact on the access of SME financing and high interest rate ( $B = -1.567, p < 0.01$ ) and information asymmetry ( $B = -1.234, p < 0.01$ ) have also negative impact on the business performance. Among these factors collateral requirements appear to be the most significant barrier reflecting the risk adverse lending practices of the financial institutions. These findings underpin the critical need for policy interventions such as alternative credit assessment mechanism, streamlining of the loan processes as well as targeted financial products for SMEs. The study is relevant to the SME financing literature because it shows some empirical evidence from the retail sector in Nepal, and has implications for policymakers and financial institutions to develop more inclusive financing frameworks.*

**Keywords:** Access to Credits, Collateral Requirement, Financial Constraint, Nepal, Retail Firms, SME Financing.

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## Introduction

In the crowded streets of the commercial heart of the city of Dhangadhi, the Sudurpashchim Province's economic capital of the hills of the Himalayas of far western Nepal, gateway to the plains to the south of India, the rich economic lifeblood of a small Himalayan nation, thousands of small retail enterprises make up the tapestry of cross-border commerce that has grown rich for generations. From successful clothing boutiques and family-owned general stores in every town and hamlet throughout the region to the state-of-the-art electronics stores lining the main bazaar of Mahendranagar, the border city that is Nepal's most westerly commercial hub connecting the hills with the Terai plains, Small and Medium Enterprises (SMEs) are the entrepreneurial spirit that is behind over 90% of Nepal's business ecosystem, employing millions and contribution significantly to the country's GDP (Joshi, 2025). Retail sector which is the critical interface between the producer and the consumer in all its different geographic terrains from the markets in the Indo-Nepal border in the Terai to the hill stations of mid-mountains are the promise and the predicament of Nepal's SME scenario (Silwal, 2024). Whilst these businesses are doing some remarkable things in overcoming the hurdles in the market, and continue to innovate, their growth trajectories are still limited because of a financial ecosystem seemingly not in structural alignment with their operational realities. The irony here is striking, a country where entrepreneurship is grown organically irrespective of the geographical and cultural context, it is the very institutions that are supposed to be helping businesses grow are the biggest barriers of access to capital. Nepal's financial transformation of the last three decades is a story of phenomenal institutional development - from a few state-owned banks centred in large cities to an ecosystem of commercial banks, development banks and microfinance institutions varied in dispersion in urban centres and the hinterland, all ostensibly to democratise access to finance (Adhikari, 2022) but yet this institutional proliferation hasn't turn into commensurate gains in access to SME financing, especially in emerging commercial centres and border towns where there's an extensive potential for trade but a relatively underdeveloped financial infrastructure. The persistence of the mismatch between the demand and the supply of finance is a more complex story: one in which regulatory frameworks, risk assessment methodologies and lending practices are not necessarily yet easily compatible with

the operational features and financing needs of retail SMEs operating in different regional environments. Consider the typical retail entrepreneur in the far western region of Nepal for instance, a second generation businessman who is manning a textile and garment business in Attariya, a thriving commercial town that is an important transit point along the Mahendra Highway that connects the far western region with the rest of Nepal where cross-border trade with India is creating dynamic market opportunities. Or imagine how a young graduate has turned the traditional family grocery store in Lamki, a fast growing municipality in Kailali district which has grown into an agricultural trading center into a modern retail outlet catering to local farmers as well as urban consumers. These entrepreneurs have intimate knowledge of the markets in their countries, customer relationships which are in place on both sides of the Nepal-India border, and experience of sustainability in business in challenging regional markets. Yet, when they approach financial institutions to seek finance to expand their stock to meet the festival seasons, or to invest in new technologies to compete with Indian retailers or to open new outlets to catch the growing trade from the region, they are faced with maze of requirements which are suited for large corporations of major cities and not for dynamic small businesses that are operating in new commercial centres (Silwal and Mool 2021) The financing issues faced by retail SMEs in Nepal are not just administrative inconveniences, but are rather systemic barriers that reverberate throughout the entire regional economies. Be it a promising retail enterprise in Dhangadhi failing to organize working capital to stock up for Dashain and Tihar festivals, the effects are not limited to that particular business, but spreads to the people who supply these stores all over the district, to employees from villages in the neighborhood, to customers who depend on cheap goods and to the economy of the region that depends upon these commercial hubs to enable trade between producers in rural areas and consumers in urban markets (Das et al.,2018).

In border cities like Mahendranagar where retail businesses represent important links in the trans-Himalayan trade networks, financial constraints can be disruptive in supply chains that stretch from Indian manufacturing centres to remote Himalayan communities creating in turn a vicious circle of sorts, where business is limited to subsistence levels of activity even where it is operating in critical locations with immense scope for growth. At the core of this conundrum of fi-

nance is a fundamental mismatch between conventional banking practices developed for traditional urban markets, and the realities of retail SME operations in emerging commercial centers in different parts of Nepal. The country's financial industries informed of prudent use of risk management practice and regulatory approaches borrowed from developed economies still focus on collateral-based lending, which favor borrowers with high real estate in urban areas, systematically excluding retail businesses in areas such as Attariya or Lamki that usually run with high inventory turnover, strategic location to their advantage and advantages, and cash-intensive business models that may seem risky to the headquarters sitting thousands of kilometers away but are shown to be profitable, as per their regional context (Thein et al., 2024). This approach discriminates severely against entrepreneurs in the far western region where the land value may be low as compared to that in Kathmandu, but where the business activity may tend to be more dynamic because of the advantages of cross-border trade and new market conditions.

The information asymmetry between lenders and retail market SMEs is compounded even further when regional variations in business practices and market conditions are taken into account. While a bank loan officer in a provincial headquarters may be able to understand the financial statements of a manufacturing company, the same professional may not be able to assess the creditworthiness of a retail enterprise whose success will depend on many other factors such as cross-border trade relationship, seasonal agricultural cycles affecting customer buying power, festival-related patterns of demand, and supplier networks that span multiple districts - intangible assets that don't find a place in balance sheets, but which define the viability of a business in regional commercial centres (Wellalage et al., 2019)). The difficulty is further complicated in cities like Dhangadhi and Mahendranagar where businesses not only have to deal with the conditions of the domestic market but also exchange rate fluctuations, cross-border regulatory changes and the competition of the Indian retailers with possible superior access to capital. This study stems from the realization that Nepal's economic development aspirations, especially that of developing regional commercial centers and taking advantage of the border trade opportunities, cannot be achieved to the fullest unless the financing constraint limiting the growth potential of retail SMEs

in the diverse geographic regions of the country are addressed. As the country works through the post-pandemic recovery and through to achieving its development goals and reducing the economic disparities across regions, understanding and overcoming the barriers to SME financing will not be merely an academic exercise, but a core part of inclusive national development strategy. The retail sector with its direct link on one side to rural producers and on the other to urban consumers, the role of retail in facilitating inter-regional trade, and the ability of the sector to generate employment in various geographical contexts, are a microcosm of the larger challenges and opportunities of the regionally distributed SME ecosystem in Nepal. Through a comprehensive examination of the financing constraints of retail SMEs across major urban centers in Nepal, ranging from well developed commercial centers to new border towns, this research attempts to shed light on the specific constraints that prevent such enterprises from accessing sufficient capital, quantify the impact on business performance within various regional contexts, and provide policy relevant evidence for policymakers and financial institutions who are interested in developing more geographically inclusive financing frameworks. The stakes could not be higher: in a country where the formal employment opportunities are still primarily concentrated in a few major cities, while entrepreneurship is the main channel of economic mobility in diverse regions of the country, ensuring that SMEs have access to growth capital irrespective of their geographical location is fundamental to achieving both inclusive and regionally balanced sustainable development. Traditional banking institutions in Nepal generally require lots of collateral, extensive documentation and established credit histories, which many retail SMEs do not meet. The main constraints are strict lending criteria, a lack of collateral, and insufficient credit history, which particularly affect the small firms than the larger firms.

## **Literature Review and Theoretical Framework**

The literature on SME financing has shown abundant evidence of the problems of SMEs in accessing adequate capital for operations and growth. The traditional financial theories based on perfect market assumptions states that efficient allocation of capital should be on the basis of price mechanism and rational lending decision (Modigliani & Miller, 1958). The financing of Small and Medium Enterprises has been a subject of extensive research globally, with particular attention

to the challenges faced by SMEs in accessing formal financial services.

### **Theoretical Basis: Credit Rationing Theory**

This research is mostly based on Credit Rationing Theory as it was proposed by Joseph Stiglitz and Andrew Weiss in the year 1981 which describes how information asymmetry between lenders and borrowers leads to imperfect credit markets. The theory is that banks are not necessarily going to adjust the interest rates to balance the demand and supply of credit because increasing the interest rates may attract riskier borrowers (adverse selection) or incentivize excessive risk taking (moral hazard). Instead, financial institutions limit credit by non-price means such as high collateral requirements, conservative screening procedures and administrative complexity and developing economies such as Nepal where formal financial records are minimal and credit information systems are largely incomplete, such mechanisms have a disproportionate impact on small and medium enterprises. Retail SMEs tend to have few fixed assets and informal accounting practices and thus are more likely to suffer credit rationing. This theoretical lens provides a systematic explanation for the emergence of the collateral requirements, high interest rates and procedural rigidities as binding financing constraints and how these constraints in turn constrain the performance of businesses.

### **Supporting Framework: Information Asymmetry Theory**

In cases of SME financing, the entrepreneurs normally can have better knowledge of their business prospect than the banks, while lenders have uncertainty of business repayment capacity and risk exposure. The analysis is also supported by Information Asymmetry Theory, especially the work of Stewart Myers and Nicholas Majluf (1984) with regards to highlighting the unequal access to information between borrowers and lenders which distorts financial decision-making. This imbalance leads to precautionary measures by financial institutions in terms of their lending practices like stringent documentation requirements, high collateral requirements and risk-adjusted interest rates. In the case of Nepal, poor financial reporting standards and a poor credit information infrastructure and informal business practices compound the information gaps. As a result, viable retail SMEs can be denied credit or provided with poor terms not because of poor

performance, but because lenders are not able to accurately assess risk. Information asymmetry therefore becomes the structural cause of the credit rationing and provides a theoretical explanation for the persistence of financing constraints on the business performance of SMEs.

**Conceptual Framework of the Study**

*Hypothesized Links Between Independent Variables and Business Performance in Retail SMEs in Nepal*

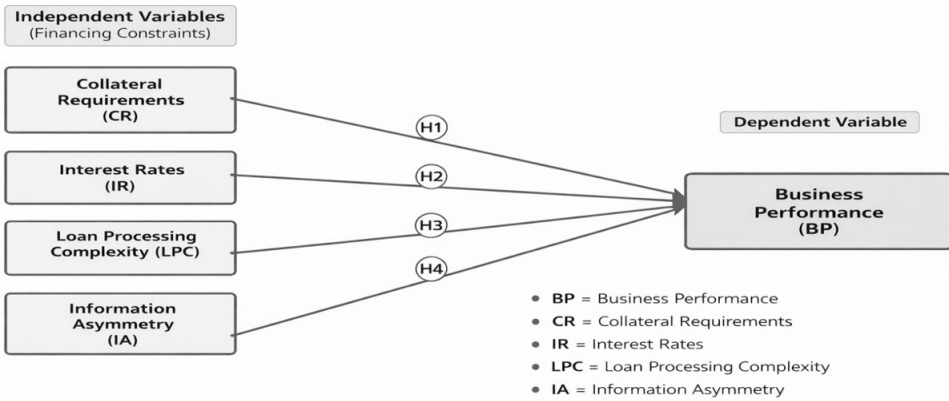


Figure 1 shows the conceptual framework of the study that indicates the hypothesized links between the independent variables and the dependent variables.

**SME Financing Constraints in Developing Economies**

The financing constraints faced by SMEs in developing countries have been extensively documented in the academic literature, and scholars have identified various factors that constrain access to formal credit (Beck et al., 2008) and such restrictions are especially prominent in countries such as Nepal, where financial markets are less well developed and institutional frameworks for SME lending are weak (Silwal, 2024).

The theoretical basis to understand SME financing constraint is based on information economics, specifically, the notions of adverse selection, moral hazard that cause market imperfections in the credit markets. Collateral requirements are one of the major hurdles in SME financing across the world, with this constraint being highly acute in the south Asian countries (Wellalage et al., 2019). In the context of Nepal, the focus on tangible collateral is a result of poor legal frameworks in enforcing contracts, poor credit information systems and therefore lending institutions have to rely on security on assets (Chaulagain, 2015). This approach excludes, in a systematic manner, the many retail SMEs with few fixed

assets but with good cash flows and business viability.

### **Interest Rates and Credit Access**

High interests rate is another important constraint to SME financing especially retail sectors where profit margins are usually limited (Nguyen et al., 2019). Nepal has an interest rate system that is a result of many factors such as monetary policy stance, banking sector competition, and risk premium of SME lending.

The research shows that SMEs in Nepal pay interest rates 2-4 percentage points higher than those charged to large corporations due to perceived higher credit risks, and due to transaction costs (Joshi, 2025).

The impact of interest rates on SME financing is beyond the aspect of cost since high interest rates may be signals of credit rationing, which affects business investment decisions (Cole & Sokolyk, 2018). For retail SMEs who operate in competitive markets and have little pricing power, high financing costs can take a dramatic toll on profitability and growth opportunities. This situation is complicated by the seasonality of many retail businesses which need flexible finance arrangements which traditional banking products often fail to offer.

### **Loan Processing Complexity and Administrative Barriers**

The complexity of the loan application processes and administrative requirements poses a serious limitation to financing SMEs, especially to smaller retail enterprises with limited administrative capacity. Nepalese financial institutions usually demand a lot of documentation which includes i.e certificate of business registration, tax clearance, financial statements, valuation of collateral, etc. Loan applicant bear huge transaction costs of documentation. These requirements are disproportionate on retail SMEs who often operate informally and are not in the position to keep complete financial records.

Research points out that the general loan processing time in the banking sector in Nepal is 45-60 days for SME loans with additional delays being common as a result of documentation issues and loan approval procedures (Silwal & Mool, 2021).

Such lengthy processes cause cash flow difficulties for retail businesses who usually need quick access to working capital to meet inventory fluctuations and sea-

sonal demands. The bureaucratic nature of the lending processes also deter many potential borrowers from seeking formal financing, and push them toward informal sources of credit, which are more costly and more risky.

### **Information Asymmetry and Credit Assessment Challenges**

The information asymmetry between the lenders and borrowers is the elementary problem of finance of small and medium enterprises (SMEs) which is very acute in the retail sector in Nepal where in many cases business operation is informal and financial records incomplete (Chaudhary et al.,2024). The financial institutions are unable to judge the creditworthiness of retail SMEs, this is because there exists the lack of standardized financial reporting, no credit history and a lack of understanding of sector specific risks and opportunities. This information gap leads to credit rationing whereby credit qualified borrowers are turned down from credit or given unfavorable credit terms as a result of inability of lenders to understand the difference between good or bad risk.

The difficulty of this is also compounded by a lack of credit bureaus and a lack of mechanisms for information sharing between financial institutions, which means that comprehensive credit profiles cannot be built up for SME borrowers. Consequently, many viable retail businesses are yet to be included in the formal financing channels despite the growth potential and contribution to economic development. The effectiveness of policy interventions critically depends on the capacity of implementing them as well as the quality of the institutions. Programs that merely increase the supply of credit without addressing the market failures that cause them are frequently not so successful (Demirguc-Kunt et al., 2009). Comprehensive approaches dealing with information asymmetries, regulatory barriers and institutional capacity constraints tend to be better. Nepal's policy framework in the area of SME financing is the result of very different initiatives, such as mandatory lending targets, subsidised credit and guarantee schemes.

However, evaluation studies suggest limited effectiveness because of implementation challenges, bureaucratic procedures and lack of institutional capacity (Das et al., 2018). The available literatures show a significant lack of knowledge on the constraints of financing SMEs in the Nepalese context. While the regional studies provide some general picture, the specific issues of retail SMEs in Nepal have to

be studied in depth empirically. This work attempts to fill such a gap through a comprehensive survey evidence and systematic analysis of barriers to financing retail enterprises.

## Methodology

This study follows the research design of descriptive and causal research methods in order to find the impact of financing constraint, i.e. collateral requirements, interest rate, loan processing complexity, and information asymmetry on the performance of retail SME business in Nepal. The quantitative approach is basically concerned with the analysis of the relation between these independent variables and dependent variables which are performance indicators of the business. A structured questionnaire was designed to obtain primary data and highlight the main aspects of SME financing problem and business outcomes. Descriptive statistical tools, such as the mean, standard deviation, and percentage tools were used to summarize the data set, whilst the multiple regression analysis provided insight into the causal relationship between the variables. The population targeted for the study include of retail SME owners and manager having active business operation in major urban centers of Nepal participating in the formal and informal financing activities.

The convenience method of sampling was taken and their sample size was 425 respondents which was statistically sufficient for a reliable analysis. Google forms was used in data collection that could reach and perform most efficiently through Google forms as the respondents were able to complete the questionnaire conveniently without any time and location restrictions. The structured questionnaire contained multiple choice and Likert scale questions, the latter of which ranged from one (Strongly Disagree) to five (Strongly Agree). Data were processed and analyzed by using the software of the statistical package (SPSS) version 25.

The demographic and business nature of the respondents was summarized with the help of descriptive statistics and the hypothesized relationships between financing constraints and business performance were tested using the regression analysis. Each of the financing constraints constructs were measured by scaling validated in prior studies.

Following Beck et al. (2008), collateral requirements reflect the challenge in com-

ing up with security to access loans. Interest rates according to Stiglitz & Weiss (1981) reflects the cost burden of financing on the operations of the business. Loan processing complexity, consistent with the framework of De la Torre et al. (2010) - measures procedural difficulties in accessing formal credit.

The concept of information asymmetry was measured through the communication gaps between the lenders and borrowers following the approach of Myers and Majluf (1984). The dependable variables are the signs of the performance of business in the retail SME sector. A regression model was applied to quantify the impact of these financing constraints on the performance of businesses which are represented by the following equation:

$$BP = \beta_0 + \beta_1 CR + \beta_2 IR + \beta_3 LPC + \beta_4 IA + e$$

Where:

- BP = Business Performance
- CR = Collateral Requirements
- IR = Interest Rates
- LPC = Loan Processing Complexity
- IA = Information Asymmetry
- $\beta_0$  = Constant
- $\beta_1$  to  $\beta_4$  = Coefficients
- e = Error terms

The coefficients ( $\beta_1$  to  $\beta_4$ ) are used to estimate the strength and direction of the relationship between each of the independent variables and the dependent variable, while e is used to represent the error term.

To provide reliability and validity, the alpha of Cronbach was estimated to be high; the coefficient of internal consistency of 0.923 among 28 items of the survey instrument was high, which indicated that the survey tool had high internal

consistency and was strong. This degree of reliability indicates that the items were able to measure the target financing constraint constructs on a consistent basis.

## Results and Discussion

### Demographic Understanding in the Characteristics and Financing Behavior of the SMEs

The result of demographic analysis provides some information about the characteristics of retail SMEs and financing behaviour. The dominance of male entrepreneurs (58.6%) in the sample was a testimony to the traditional gender patterns of ownership in business. Middle-aged group of entrepreneurs with age group 31 - 40 years are the biggest group (42.1%) signify on mature business leadership. Education-wise, graduates take the lead at 51.3% which reflects the rising level of education of SME owners. . Business owners were the largest occupational category (67.8%) followed by professionals (22.4%). The majority of the respondents (48.9%) had 5-10 years of experiences in business and 28.2% were experienced operators with more than 10 years of experiences. Finally, the majority (61.4%) have contacts with formal financing on the occasion, implying cautious, but strategic approaches to credit utilization.

**Table 1: Demographic Profile of Retail SME Respondents**

Demographic Variable	Category	Frequency	Percentage (%)
Gender Distribution	Male	249	58.6
	Female	176	41.4
Age Category Distribution	25-30	102	24
	31-40	179	42.1
	41-50	98	23.1
	Above 50	46	10.8
Education Status Distribution	School Level	89	20.9
	Undergraduate	118	27.8
	Graduate	218	51.3
Occupation Distribution	Business Owner	288	67.8
	Professional	95	22.4
	Service	42	9.8
Business Experience Distribution	2-5 Years	98	23.1
	5-10 Years	208	48.9
	Above 10 Years	119	28.0

Financing Frequency Distribution	Frequently	89	20.9
	Occasionally	261	61.4
	Rarely	75	17.7

## SME Financing Constraints: Reliability and Behavioral Insights Collateral Requirements

The results on collateral requirements underlines the fact that SMEs have heavy barriers in meeting security requirements for access to loans. The score with the greatest mean ( $M = 4.23$ ) expresses a high degree of concern as to adequate collateral for loans for business, and a large number of respondents indicated they have difficulty meeting the bank standards of collateral ( $M = 4.05$ ). This is further reinforced by the attitude not to take loan because of collateral constraints ( $M = 3.89$ ). Lower scores on the utilization of personal assets as collateral ( $M = 3.67$ ) and limited business assets as security ( $M = 3.45$ ) reflect moderate availability of collateral in general. These findings indicate that collateral requirements are the most important financing constraint for retail SMEs.

**Table 2: Collateral Requirements**

Collateral Requirements	Mean	SD
Concern about providing adequate collateral for business loans	4.23	0.72
Difficulty meeting bank collateral standards	4.05	0.68
Avoid seeking loans due to collateral constraints	3.89	0.74
Reluctance to use personal assets as collateral	3.67	0.71
Limited business assets available for loan security	3.45	0.69

## Interest Rates

The results of the interest rate show that financing cost is considered as a major constraint by SMEs in business operations. The mean score ( $M = 4.15$ ) highest, represent high concern about high interest rates affect business profitability while substantial burden from loan interest payments ( $M = 3.98$ ) highlight cost. Difficulty in managing interest obligations ( $M = 3.76$ ) is a further support to financial

strain. Lower postpone expansion from interest cost ( $M = 3.52$ ) and compare rates across institution ( $M = 3.29$ ) suggest moderate adaptation strategies. Overall, therefore, results suggest high rates of interest as one of the vital funding constraints to growth and sustainability of SMEs.

**Table 3: Interest Rates**

Interest Rates	Mean	SD
High interest rates have significantly impact on business of profitability	4.15	0.71
Interest payments cause significant pressure on cash flow	3.98	0.73
Trouble in managing interest payment obligations	3.76	0.68
Defer business expansion because of high interest costs	3.52	0.72
Compare interest rates between several institutions	3.29	0.75

### Loan Processing Complexity

The results in the case of the complexity of loan processing is that SMEs have a lot of administrative barriers in accessing formal credit. The highest score ( $M = 4.08$ ) on average is attributed to the Extensive documentation requirements put up obstacles and represent major obstacles while lengthy loan approval procedure ( $M = 3.91$ ) is the source of operational challenges. Complex application procedures ( $M = 3.73$ ) are contributing to problems of access. Lower scores on the means of clear about some loan requirements ( $M = 3.45$ ) and seeking help with professional in loan applications ( $M = 3.21$ ) are efforts to maneuver through the procedural complexity. This implies that while SMEs are struggling with the bureaucratic processes, there is an active search for the solutions towards overcoming these barriers.

**Table 4: Loan Processing Complexity**

Loan Processing Complexity	Mean	SD
Extensive documentation requirements put up obstacles	4.08	0.70
Difficult to obtain loans on time due to lengthy loan approval procedure	3.91	0.69

Complex application procedures difficult to navigate	3.73	0.71
Problems in comprehending some loan requirements	3.45	0.68
Get the help of professional in loan applications	3.21	0.74

### Information Asymmetry

The results showed that there is information gap between SMEs and lenders result in moderate financing constraints. The highest mean score ( $M = 3.87$ ) indicates that poor communication with banks influence loan decision followed by lack of transparency in lending criteria ( $M = 3.65$ ). Lower mean scores of understanding reasons for rejection ( $M = 3.42$ ), access to financial advice ( $M = 3.18$ ) and bank knowledge of business models ( $M = 2.95$ ) suggest levels of varying information challenges. This shows that although there is information asymmetry, this is a lesser constraint than collateral requirements and interest rates.

**Table 5: Information Asymmetry**

Information Asymmetry	Mean	SD
Poor communication with banks affects loan decisions	3.87	0.69
Lack of transparency in bank lending criteria	3.65	0.71
Difficulty understanding reasons for loan rejection	3.42	0.67
Limited access to financial advisory services	3.18	0.73
Banks have inadequate knowledge of retail business models	2.95	0.68

### Business Performance

The outcomes on business performance show average levels of performance on key performance indicators. Revenue growth has the highest mean score ( $M = 3.52$ ) which indicates a reasonable growth of business despite the financing constraint. Operational efficiency comes next ( $M = 3.34$ ) which denotes effective utilization of resources. Lower mean scores for expansion capability ( $M = 3.15$ ), investment in new technology ( $M = 2.98$ ) and market share growth ( $M = 2.81$ ) indicate limitations imposed by financing constraints. This implies that while SMEs are keeping their basic operations, the growth of SMEs and modernization of operations are limited by the lack of access to capital.

**Table 6: Business Performance**

Business Performance	Mean	SD
Revenue growth over the past three years	3.52	0.78
Operational efficiency in resource utilization	3.34	0.72
Capability to pursue expansion opportunities	3.15	0.81
Investment in new technology and equipment	2.98	0.75
Market share growth in retail sector	2.81	0.73

### Correlation Analysis

The correlation matrix provides us with information regarding relationship between Collateral Requirements, Interest Rates, Loan Processing Complexity, Information Asymmetry and Business Performance. Collateral Requirements and Interest Rates showed a strong positive relationship ( $r=.756$ ,  $p<0.01$ ), suggesting that high collateral requirements have been related to high cost financing. Loan Processing Complexity is also positively correlated with both Collateral Requirements ( $r=.721$ ,  $p < 0.01$ ) and Interest Rates ( $r=.698$ ,  $p < 0.01$ ), thus, there is a complicated process along with stringent lending requirements. Information Asymmetry showed moderate positive correlations with all financing constraints, which means that communication gaps add to other obstacles. Regarding Business Performance, Collateral Requirements ( $r = -.542$ ,  $p < 0.01$ ) and Loan Processing Complexity ( $r = -.518$ ,  $p < 0.01$ ) have the highest negative correlation between the two which means that they have the most adverse consequences on business. Interest Rates ( $r = -.467$ ,  $p < 0.01$ ) and Information Asymmetry ( $r = -.378$ ,  $p < 0.01$ ) are also found to have a negative impact on the performance but to a lesser extent.

Overall, these results point to the interdependency between financing constraints and the combined impact on SME performance.

**Table 7: Correlation Matrix**

Variables	Collateral Re-quirements	Interest Rates	Loan Processing Complexity	Information Asymmetry	Business Per-formance
Collateral Re-quirements	1				

Interest Rates	.756**	1			
Loan Processing Complexity	.721**	.698**	1		
Information Asymmetry	.612**	.589**	.634**	1	
Business Performance	-.542**	-.467**	-.518**	-.378**	1

\*Note: N = 425 for all variables.

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

### Regression Analysis

A constant value of 4.785 is the baseline level of business performance when all the predictors are maintained constant. Collateral Requirements (B = -2.143, Beta = -1.234, t = -18.765, Sig. = 0.000) and Loan Processing Complexity (B = -1.892, Beta = -1.089, t = -16.432, Sig. = 0.000) show the highest negative impacts, meaning that SMEs with high collateral requirements and complicated processing have much lower business performance. Interest Rates (B = -1.567, Beta = -0.876, t = -13.254, Sig. = 0.000) And Information Asymmetry (B = -1.234, Beta = -0.623, t = -9.876, Sig. = 0.000) also have significant negative effects but to a somewhat lesser degree. The predictors are all statistically significant which highlights their importance in limiting SME business performance.

**Table 8: Coefficient of Regression**

Predictor	B	Std. Error	Beta	t	Sig.
(Constant)	4.785	0.142		33.697	0.000
Collateral Requirements	-2.143	0.114	-1.234	-18.765	0.000
Interest Rates	-1.567	0.118	-0.876	-13.254	0.000
Loan Processing Complexity	-1.892	0.115	-1.089	-16.432	0.000
Information Asymmetry	-1.234	0.125	-0.623	-9.876	0.000

Note: Dependent variable is Business Performance.

The hypothesis of the negative effect of collateral requirements on business performance (H1) is well supported by the significant negative effect found (B = -2.143, Beta = -1.234, p < 0.01). This confirms that there are enormous performance constraints for SMEs that cannot meet the demands for collateral. Simi-

larly, H2 positing that high interest rates have adverse effects on the performance of businesses is accepted ( $B = -1.567$ ,  $Beta = -0.876$ ,  $p < 0.01$ ) suggesting that financing cost has a substantial burden on SME business operations. H3, which predicts that the complexity of loan processing affects performance adversely, is well supported ( $B = -1.892$ ,  $Beta = -1.089$ ,  $p < 0.01$ ), indicating that bureaucratic procedures hamper the growth of the business. Finally, the hypothesis H4 which proposes that information asymmetry has a negative impact on performance, is accepted ( $B = -1.234$ ,  $Beta = -0.623$ ,  $p < 0.01$ ), even though this constraint reveals the weakest effect of all the factors.

## Discussion

The results of this research provide significant information about financing constraints in retail SMEs in the emerging economy of Nepal. These findings are in line with the established theories of SME financing, but shows context specific patterns representing the condition of Nepal's market and its institutional framework.

Collateral requirements have proven to be the most severe constraint and SMEs remain very concerned with security requirements to obtain loans. This would be in line with the theory of credit rationing (Stiglitz & Weiss, 1981) which implies that information asymmetries lead lenders to use collateral as a risk mitigation tool to a large extent. In Nepal, the strong negative impact of collateral requirements on the performance of businesses ( $B=-2.143$ ,  $p<0.01$ ) is consistent with the results of existing research that suggest the asset-light nature of retail operations and the incongruence with conventional lending practices (Beck et al., 2008; Wellalage et al., 2019).

Interest rates are also an important factor when it comes to limiting the performance of SMEs as high financing costs deter SMEs from investing and growing their business ( $B = -1.567$   $p < 0.01$ ). Unlike large corporations who have access to capital markets, the SMEs in Nepal rely on bank financing which makes them especially vulnerable to the effect of fluctuations in interest rates (Cole and Sokolyk, 2018). This increased sensitivity is further supported by narrow profit margins that are typical for retailing operations as well as the lack of pricing flexibility in competitive markets (Stein, 2002).

The complexity of loan processing has a significant impact on the performance of the business ( $B = -1.892, p < 0.01$ ) and proves that bureaucratic procedures represent many impediments to SMEs with limited administrative ability. This finding squares with research on transaction costs in SME lending (Berger and Udell, 2006), in which complicated application requirements are a disproportionate burden for smaller enterprises. In Nepal, this is complicated by poor institutional frameworks and low levels of standardization of lending procedures amongst financial institutions.

Information asymmetry Although showing a significant negative relationship ( $B = -1.234, p < 0.01$ ), information asymmetry is the weakest of all the constraints. This would suggest that whilst communications gaps between lenders and borrowers are contributing to problems in financing, there are other structural barriers that are more immediate challenges. The rather modest effect may reflect adaptation strategies of SMEs such as finding informal sources of financing or depending on relation-based lending arrangements, which are prevalent in Nepal's financial system.

### **Policy Recommendations**

**Alternative Credit Assessment Mechanisms:** Financial institutions should create sector specific lending products that are based on cash flow analysis, business performance indicators and alternative collateral arrangements rather than traditional fixed asset requirements and whereas government support of credit guarantee schemes could help with this transition as successful implementations have been made in other developing countries [Demirguc-Kunt et al., 2009].

**Streamlined Lending Procedures:** Regulatory authorities to insist on simplified loan application procedures for SMEs including digital platforms, reduced documentation requirements and standard application processing timelines. Training programmes on best practices of SME lending for the bank personnel could be useful in better service delivery.

**Interest Rate Interventions:** These interventions should be carefully designed in order to avoid market distortions and attain developmental objectives Targeted interest rate subsidies or refinancing facilities to SME lending could make financing cheaper and easier to access.

**Information Infrastructure Development:** Setting up credit bureaus, business information platforms and sector specific databases could be helpful in reducing information asymmetries and increase the accuracy of credit assessments. Models from other neighboring countries, public-private partnerships could help make these things happen.

### **Limitations and Future Research**

This research is focusing on urban retail SMEs and may not fully represent the experience of rural enterprises or others. Future studies should examine financing constraints for different sectors of SMEs and geographic locations so that the financing landscape can be fully understood.

Longitudinal studies into access to SME financing and business performance over time might provide some insight into the dynamic nature of the constraints and the effectiveness of policy interventions. In addition, work on the supply-side of the perspective of financial institutions may offer complementary information on lending decision and risk assessment practices.

Further investigation into the role of informal sources of financing and their interaction with formal credit markets would give a more complete picture about SME financing ecosystem in Nepal. Studies that focus on how effective digital financial services and fintech solutions have been in integrating conventional constraints in the field of finance would also be useful.

### **Conclusion**

Financing constraints - collateral requirement, rate of interest, complexity of processing of loan application, and asymmetric information have a significant negative influence on the performance of business of retail SMEs in Nepal. Collateral requirements and complexity in loan processing are the major hurdle while interest rate and information asymmetry also are major sources of restriction on business operations and growth. Collateral requirements became the most powerful factor, which was the outcome of division between conventional banking and the asset-lightness of retail operations and from these findings emphasise the need of addressing structural barriers in the SME financing ecosystem in Nepal where lack of institutional capacity and risk aversion in lending practices amplify the problem of financial exclusion.

This study adds to the SME financing literature by giving localized understanding of the problems in the retail sector and highlight the need for development of alternative financing mechanism and policy interventions for inclusive economic growth. The result is consistent with the result obtained recently by Joshi (2025) on financing constraints of Nepalese SMEs and complement the work done by Silwal (2024) on financial constraints in Nepalese firms. Several strategies have been put forth which would have better access to the SME financing and increase the performance of businesses. First, alternative assessment of credit needs to have an emphasis on cash flow analysis and viability of business operations as opposed to traditional collateral requirements. Policymakers should reduce the loan processing process and develop standard documentation requirements among financial institutions. Interest rate subsidies or refinancing facilities could help to bring down the cost of financing for SMEs, while the credit guarantee schemes can help hedge lender risk. Better information sharing platforms and sector-specific lending products will reduce communication gaps between lenders and borrowers whereas Integrating these interventions as part of a comprehensive SME financing strategy will help build more resilient economies, and to achieve sustainable growth of businesses.

The finding of the study support the need of financial literacy programs as emphasized by Chaulagain (2015) in assisting the SME owners such that they can understand the banking procedures and requirements better. Furthermore, the research reiterates the importance of overcoming the gender-specific barriers in the financing of SMEs as pointed out by the recent research done on the women entrepreneurs in Nepal. About the collaboration between regulatory authorities, financial institutions, development partners and SME associations is important to create a more inclusive and effective financing ecosystem to support Nepal's economic development goals. The presented evidence in this study provides a basis for evidence-based policy making, institutional reforms in order to tap the growth potential of Nepal's vibrant SME sector.

Future policy initiatives should consider regional differences in business practices and market conditions and particularly border areas where cross-border trade causes unique opportunities and challenges. The development of special financial

products for retail SMEs which are tailored based on their seasonal pattern of cash flows and inventory based business models is a major mile-stone of the search for financial inclusion and sustainable economic growth. The results of the regression analysis indicate that collateral requirements, interest rates, loan processing complexity and information asymmetry have a significant relationship with business performance. The model fit statistics ( $R^2$ ) suggest that a significant percentage of variance in business performance is accounted for by these financing constraints and the F-test confirms that the overall model is statistically significant.

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