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Assessing the Effectiveness of SMEs Loans in Mahendranagar: Utilization, Misuse, and Growth Barriers

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Abstract

Small and Medium Enterprises (SMEs) are the backbone of local economies, especially in emerging regions like Mahendranagar, Nepal. Despite the availability of various loan products from financial institutions, their effectiveness in supporting business growth remains inconsistent. This study investigates the role of loan products in enhancing SME performance, identifies challenges in loan utilization, and explores key issues such as financial literacy, misuse of loans, and loan monitoring gaps. Data were collected through field surveys, interviews with business owners, and analysis of bank reports. Findings highlight the need for improved financial education, stricter loan monitoring, and customized loan products. Recommendations include better financial literacy programs, stronger monitoring systems, and tailored banking services to address the unique needs of SMEs.

Keywords: *SME Loans, Financial Literacy, Loan Monitoring, Business Sustainability*

Introduction

Small and Medium Enterprises (SMEs) are vital components of economic and social development, particularly in developing nations like Nepal. These enterprises significantly contribute to local economies by creating jobs, promoting entrepreneurship, and driving innovation. Representing around 90 percent of businesses in Nepal (World Bank, 2021), SMEs provide livelihood opportunities to a large portion of the population. Their importance is especially pronounced in regions like Mahendranagar, where they form the backbone of community-based economic activities.

In Mahendranagar, it is common for SME owners to divert loans meant for business purposes into personal expenditures, such as purchasing property or funding education

abroad. For instance, survey findings from this study revealed that 40% of SMEs redirected loan funds for non-business purposes. This misallocation reduces the effectiveness of loans, creating repayment challenges and negatively affecting business growth.

Mahendranagar, located in Sudurpaschim Province's Kanchanpur district, exemplifies the transformative role of SMEs in fostering regional development. Businesses such as retail shops, garment outlets, grocery stores, and small-scale manufacturing units are pivotal in addressing local unemployment and improving productivity. Despite their substantial impact, SMEs in the region face significant obstacles that hinder their long-term sustainability and growth. Chief among these challenges is access to affordable finance. Many small entrepreneurs find it difficult to navigate the formal lending system due to complex requirements, including high collateral demands and detailed documentation processes.

Even when financing is secured, improper fund utilization often undermines its intended benefits. In Mahendranagar, it is common for SME owners to divert loans meant for business purposes into personal expenditures, such as purchasing property or funding education abroad. This misallocation of resources reduces the effectiveness of loans and contributes to repayment challenges. Additionally, financial literacy remains a pressing issue, with many entrepreneurs struggling to manage budgets, plan investments, or forecast revenues effectively.

Efforts by Nepal Rastra Bank to address these issues include policies designed to enhance financial access, such as interest subsidies, collateral-free loans, and credit guarantees. While these measures have improved credit availability, their effectiveness is often diminished by limited awareness and insufficient monitoring systems. For instance, the absence of digital tools to track loan utilization makes it difficult for financial institutions to ensure proper fund allocation.

This study focuses on Mahendranagar as a case to explore the opportunities and barriers faced by SMEs in accessing and managing financial support. By analyzing real-life examples, the research aims to evaluate how loans are utilized, uncover recurring challenges, and assess the impact of existing policies. The findings aim to provide actionable recommendations, including strategies for improving financial literacy,

enhancing loan monitoring, and fostering collaboration between stakeholders to create a supportive business ecosystem.

By examining these issues, the study seeks to emphasize the vital role SMEs play in regional economic development. With its diverse range of businesses, Mahendranagar serves as a microcosm for understanding the broader challenges and opportunities facing SMEs in Nepal. The insights derived from this analysis can inform targeted interventions to promote sustainable growth and economic resilience in similar regions across the country.

This study focuses on Mahendranagar as a case to explore the opportunities and challenges SMEs face in accessing and managing financial support. It examines how loans are utilized, identifies key obstacles such as financial literacy gaps and loan misuse, and assesses the effectiveness of current financial policies. Through surveys, interviews, and case studies, this research aims to provide practical recommendations to improve financial literacy, strengthen loan monitoring, and enhance collaboration between SMEs, financial institutions, and regulators. The findings will help create a supportive business environment, ensuring that loan products contribute to sustainable SME growth in Mahendranagar and similar regions.

Review of Literature

Importance of SMEs in Economic Growth

Small and Medium Enterprises (SMEs) play a crucial role in economic development, contributing to over 50% of employment and up to 40% of GDP in developing countries (World Bank, 2021). In Nepal, SMEs account for 90% of registered businesses, making them key drivers of employment and innovation (FNCCI, 2022). Despite their significance, SME growth is often restricted by financial constraints, as nearly 60% of SMEs in Nepal report difficulties in securing formal credit (Nepal Rastra Bank, 2022). Other major challenges include inadequate infrastructure, limited access to technology, and market fluctuations (Asian Development Bank, 2022).

Financial Access for SMEs

Access to finance remains one of the major challenges for SME growth. Studies show that nearly 60% of SMEs in Nepal face difficulties securing bank loans due to high collateral requirements, complex application procedures, and stringent credit assessments (Nepal Rastra Bank, 2023). As a result, a significant portion of SMEs around 40% turn to informal lenders, where interest rates often exceed 30% annually, leading to high financial risks (International Finance Corporation, 2021). To address this, Nepal Rastra Bank has introduced policies such as mandatory SME credit allocations and collateral-free microloans, yet challenges persist due to lack of awareness and accessibility issues.

Loan Utilization and Challenges

Proper loan utilization is a cornerstone of SME success, yet many businesses struggle in this regard. In Nepal, loans intended for business expansion are frequently misused for personal expenses, such as purchasing land or funding education abroad. This diversion not only hampers business growth but also increases the likelihood of loan default, affecting the creditworthiness of borrowers and the financial stability of lenders. Furthermore, many SME owners lack the necessary financial planning skills to allocate borrowed funds efficiently. Without clear business strategies, funds are often used for short-term needs rather than long-term growth. External factors, such as market volatility and operational risks, further exacerbate these challenges, making effective loan utilization an area requiring urgent attention.

Nepal Rastra Bank's Provisions for SME Financing

Nepal Rastra Bank (NRB) has implemented various policies to improve access to credit for SMEs and support their growth. These include mandatory credit allocation, collateral-free loans of up to NPR 2 million for micro-enterprises, and interest subsidies of up to 5% for loans in priority sectors like agriculture and manufacturing. Additionally, NRB has introduced refinancing facilities to assist SMEs affected by economic downturns and credit guarantee schemes to encourage banks to lend to higher-risk enterprises. While these measures have increased the availability of credit, their implementation has been inconsistent. Many SME owners are unaware of these provisions, and banks often face difficulties in ensuring compliance with policy requirements.

Financial Literacy and its Impact on SMEs

Proper loan utilization plays a crucial role in SME sustainability, yet many businesses face challenges in this aspect. Studies indicate that in Nepal, around 40% of SME loans are misused for non-business purposes, such as land purchases and overseas education funding (Nepal Rastra Bank, 2023). This misallocation significantly affects loan repayment rates, increasing the likelihood of defaults. Furthermore, financial literacy is a key factor in loan effectiveness. Research by the OECD (2020) highlights that SMEs with strong financial knowledge are 50% more likely to reinvest profits into business expansion and maintain timely repayments. However, in Nepal, approximately 65% of SME owners lack formal financial training, leading to difficulties in budgeting, forecasting, and resource management (Nepal Rastra Bank, 2022).

Role of Digitalization in SME Growth

Digital tools have revolutionized how businesses operate, offering solutions for payments, inventory management, and financial tracking. For SMEs in Mahendranagar, adopting digital systems can increase efficiency, reduce costs, and enhance transparency. Mobile banking, digital wallets, and point-of-sale systems enable businesses to maintain accurate records and streamline transactions. However, the adoption of these technologies is limited due to infrastructure challenges, such as unreliable internet access, and low digital literacy among business owners. Expanding digital literacy programs and investing in infrastructure development are crucial to maximizing the benefits of digitalization for SMEs in Nepal.

Sector-Specific Challenges in Mahendranagar

The challenges faced by SMEs vary significantly by sector, necessitating tailored interventions. In Mahendranagar, retail businesses often struggle with inventory management and competition from larger outlets. Agricultural enterprises face unique risks, including weather uncertainties and fluctuating market prices, which can severely impact profitability. The hospitality sector, which includes restaurants and guesthouses, requires constant investment in quality upgrades and customer service to remain competitive. Addressing these sector-specific challenges requires innovative solutions, such as targeted loan products, technical assistance, and capacity-building programs that equip businesses with the skills and resources needed to overcome these barriers.

Lessons from International Practices

Globally, successful SME financing models provide valuable lessons for Nepal. In India, digital lending platforms have streamlined credit access for small businesses, reducing processing times and costs. Kenya's mobile money solutions have revolutionized financial inclusion, enabling even micro-enterprises to access credit and manage transactions seamlessly. These examples highlight the importance of leveraging technology and tailoring financial solutions to local needs. By adopting similar practices, Nepal can create an ecosystem where SMEs thrive, contributing to inclusive and sustainable economic growth.

The Need for Collaboration

Collaboration among financial institutions, government bodies, and community organizations is critical for fostering SME development. Joint efforts can streamline access to resources, ensure consistent monitoring, and provide mentorship opportunities for entrepreneurs. For instance, partnerships between banks and local governments can facilitate the delivery of financial literacy programs and sector-specific support. Additionally, community organizations can act as intermediaries, bridging the gap between SMEs and formal financial institutions. A collaborative approach can ensure that policies and initiatives are effectively implemented, maximizing their impact on SME growth and sustainability.

Methodology

This study adopts a systematic mixed-methods approach to provide an in-depth analysis of the utilization, challenges, and effectiveness of SME financing in Mahendranagar. By combining both qualitative and quantitative data, the methodology ensures a holistic understanding of the issues faced by SMEs while also allowing for actionable recommendations based on real-world evidence.

Structured surveys were conducted with 50 SME owners from diverse sectors, including retail, agriculture, manufacturing, hospitality, and services. The questionnaire covered a range of topics such as loan usage patterns, financial literacy, repayment challenges, and perceived barriers to growth. The survey also included questions on the awareness and effectiveness of government financial policies. In-depth, semi-structured interviews were conducted with 10 key informants, including bank RMs, loan officers, cooperative

representatives, and microfinance institution personnel. These interviews provided detailed insights into the lending processes, challenges in loan monitoring, and observations on SME financial behavior. Open-ended questions allowed participants to share experiences and perspectives freely. This study incorporates case studies to complement quantitative findings and provide a deeper understanding of SME loan utilization. While surveys and statistical data capture overall trends, they may not fully explain the underlying reasons behind loan misuse, repayment struggles, or successful financial management. Case studies allow for an in-depth exploration of individual business experiences, highlighting real-world challenges and decision-making processes that impact loan effectiveness.

Five SMEs from different sectors were selected to ensure diversity in financial behavior and industry-specific issues. These case studies illustrate how factors such as financial literacy, risk management, and loan monitoring influence business success or failure. By analyzing real-life scenarios, this research bridges the gap between numerical findings and practical insights, offering valuable recommendations for financial institutions, policymakers, and SME owners.

Secondary data was gathered from a variety of sources such as Official Reports of the selected SMEs. A purposive sampling method was employed to ensure that the study represented the most relevant businesses and stakeholders in Mahendranagar. The criteria for selecting SMEs included:

- a. Businesses that had availed loans within the last three years to ensure contemporary relevance.
- b. Representation across key economic sectors, including retail, agriculture, and services.
- c. A mix of micro, small, and medium-sized enterprises to reflect varying financial and operational capacities.

Similarly, financial institutions were selected based on their active involvement in SME financing, including commercial banks, cooperatives, and microfinance organizations operating in the region.

Survey responses were compiled and analyzed using statistical tools to identify patterns and trends. Key metrics such as the proportion of loans misused, repayment challenges,

and the relationship between financial literacy and business performance were examined. Descriptive analysis was applied to both structured and open-ended questionnaire responses to identify key patterns and trends in SME loan utilization. For structured responses, numerical data were summarized using percentages, averages, and frequency distributions. For open-ended responses, a thematic approach was used, where responses were categorized based on recurring themes such as financial literacy, loan misuse, repayment challenges, and business expansion. This method allowed for the identification of common issues among SMEs while preserving the depth of qualitative insights. The integration of both quantitative and qualitative data ensured a comprehensive analysis of the challenges and opportunities SMEs face in accessing and utilizing financial support.

Thematic analysis was applied to interview transcripts and case study narratives to identify recurring themes and insights. The analysis focused on understanding systemic barriers, individual decision-making processes, and the impact of external factors like market fluctuations and regulatory constraints. Each case study was evaluated to extract lessons that could inform broader recommendations.

A comparative approach was adopted to align primary data findings with secondary sources. This method helped validate trends observed in the field and provided a contextual framework for interpreting results. For example, insights from SME owners were compared against regional and national statistics to assess alignment or deviations.

Ethical Considerations

The study adhered to strict ethical standards to ensure the privacy and confidentiality of all participants. Key ethical practices included:

- a. **Informed Consent:** All participants were briefed about the study's objectives and voluntarily provided written or verbal consent before participating.
- b. **Anonymity:** Personal and business identities were anonymized in survey data, interview responses, and case study narratives to protect privacy.
- c. **Transparency:** Participants were informed about how their data would be used, and they had the option to withdraw from the study at any point.
- d. **Data Security:** Collected data was stored securely and used solely for the purposes of this research.

Limitations

While the study provides valuable insights, it is not without limitations:

- a. Geographic Focus:** The findings are specific to Mahendranagar and may not fully represent SME challenges in other parts of Nepal, particularly in more urbanized or remote areas.
- b. Sample Size:** Although the sample was diverse, the relatively small number of participants limits the generalizability of the results to all SMEs.
- c. Secondary Data Gaps:** The availability of comprehensive, up-to-date secondary data on SME activities in Mahendranagar was limited, posing challenges in contextualizing certain findings.

Despite these limitations, the mixed-methods approach and the inclusion of diverse perspectives ensure that the study offers meaningful and actionable insights into the realities of SME financing in Mahendranagar.

Case Studies

The following case studies highlight real-life scenarios of SMEs in Mahendranagar and their experiences with loan utilization. These cases represent both successful and challenging outcomes, illustrating the broader themes of financial literacy, loan misuse, sector-specific challenges, and the impact of external factors. All names of businesses and individuals in the following case studies have been anonymized to protect their privacy and maintain confidentiality.

The Misused Opportunity: A Retail Venture

Mr. Sharma, the owner of a retail business in Mahendranagar, secured a loan of NPR 1,500,000 from a commercial bank with the intention of expanding his inventory and upgrading his shop. Initially, he used a portion of the loan to stock high-demand products, resulting in a 30% increase in monthly revenue within six months. Encouraged by this growth, Mr. Sharma considered using the remaining funds to invest further in his business.

However, financial pressure from personal commitments led him to redirect a significant portion of the loan toward covering his daughter's wedding expenses. This diversion of funds disrupted his repayment schedule, as the additional revenue

generated by his business was insufficient to meet the loan's monthly installment requirements. Over time, repayment delays damaged his creditworthiness, and the bank initiated legal action to recover the outstanding amount.

This case underscores the critical need for separating personal and business finances. It also highlights the importance of financial literacy and effective monitoring mechanisms to ensure that loans are used as intended. Had Mr. Sharma been better informed about loan management or had access to mentorship, he might have been able to avoid misusing funds and sustain his business growth.

Transport Collapse: A Tale of Overextension

Mr. Raut, a transportation business owner, acquired a loan of NPR 20 million to expand his fleet by purchasing five additional trucks. In the first year, the investment appeared successful, as consistent earnings allowed him to meet repayment obligations and cover operational expenses. However, unforeseen risks soon destabilized the business.

Two of the newly purchased trucks were involved in accidents, resulting in significant damages. While the vehicles were insured, the claims covered only a portion of the losses, leaving Mr. Raut with reduced operational capacity and mounting repair costs. To address these challenges, he borrowed an additional NPR 5 million to settle debts and maintain operations. Unfortunately, a slowdown in market demand further strained his finances, making loan repayments unmanageable. Eventually, the business had to shut down, leaving Mr. Raut in severe financial distress.

This case illustrates the importance of risk management in SME operations. Adequate insurance coverage, contingency planning, and diversified income sources could have helped Mr. Raut navigate these challenges. Additionally, sector-specific loan products, such as financing tied to insurance against operational risks, could have mitigated the impact of unforeseen events.

Agro-Investments Gone Awry

Ms. Bista, an agro-entrepreneur specializing in vegetable farming, obtained a loan of NPR 2 million to expand her operations. Her plan involved acquiring better seeds, fertilizers, and irrigation equipment to boost productivity. Initially, the investment showed promise, as her farm began yielding higher-quality produce, leading to increased sales in the local market.

However, instead of reinvesting all the profits into her business, she lent half of the loan amount to a relative at a higher interest rate, hoping to generate additional income. Unfortunately, the relative defaulted on the informal loan, leaving her unable to fund essential operations or repay the bank. As a result, the bank foreclosed on her collateral property, causing her business to collapse.

This case highlights the dangers of deviating from loan objectives and the risks of engaging in informal lending. It also underscores the importance of financial discipline and adhering to a business plan. Structured financial literacy programs tailored for agro-entrepreneurs could have equipped Ms. Bista with the knowledge needed to manage her finances more effectively.

Successful Growth: The Model Boutique

Ms. Thapa, the owner of a small boutique in Mahendranagar, is an inspiring example of effective loan utilization. She borrowed NPR 300,000 from a local cooperative to upgrade her equipment and add high-quality inventory to her store. With a clear business plan, she focused entirely on enhancing her product offerings and reaching a wider customer base.

Using digital marketing strategies, including social media promotions, she managed to double her customer base within a year. Her monthly revenue grew from NPR 50,000 to NPR 150,000, enabling her to repay the loan on time and secure a larger second loan for further expansion. By reinvesting profits and maintaining strict financial discipline, she transformed her boutique into one of the most popular stores in the region.

This case demonstrates the transformative potential of disciplined loan utilization, financial planning, and leveraging technology for business growth. It also highlights how proper guidance and access to digital tools can enable SMEs to achieve sustainable success.

Misaligned Priorities in Restaurant Management

Mr. Khadka, a restaurant owner in Mahendranagar, secured a loan of NPR 1 million to renovate his dining space and expand his menu offerings. The intention was to attract more customers and compete with newer establishments in the area. However, instead of using the funds for these purposes, he decided to invest in a piece of land, hoping for future appreciation.

While the land's value increased over time, the restaurant's declining revenue due to poor management left him unable to meet loan repayments. As a result, the bank seized the land, causing him to lose both the investment and the opportunity to grow his business. The restaurant eventually closed, leaving him in financial ruin.

This case underscores the importance of aligning loans with business priorities and adhering to well-defined growth strategies. It also highlights the need for robust monitoring systems to ensure that borrowed funds are used as intended.

Findings of Case Studies

The case studies highlight recurring patterns in SME loan utilization, revealing how financial behavior, business strategy, and external risks influence repayment outcomes. While some businesses successfully leveraged loans for expansion, others faced setbacks due to financial mismanagement, unforeseen circumstances, or inadequate loan monitoring.

One of the most pressing concerns is loan misuse, as seen in the case of Mr. Sharma's retail business, where more than 50% of the loan was diverted toward personal expenses. This issue is widespread, as survey results indicate that 42% of SMEs in Mahendranagar admitted to misallocating business loans for non-business purposes. Similarly, Ms. Bista's agricultural enterprise suffered financial losses when she loaned a portion of her borrowed capital to a relative, leading to repayment difficulties. These cases reinforce the need for stronger financial discipline and better awareness among SME owners about the consequences of fund diversion.

On the other hand, effective loan utilization was evident in cases such as Ms. Thapa's boutique, where careful financial planning and reinvestment in inventory led to a 200% increase in revenue within a year. Her disciplined approach demonstrates how proper business planning, digital marketing strategies, and reinvestment can maximize loan benefits. This aligns with broader research findings, which indicate that SMEs with higher financial literacy levels are significantly more likely to achieve business growth and sustain repayments.

However, even well-planned loans can be disrupted by external risks. The case of Mr. Raut's transport business illustrates the impact of unforeseen challenges, where vehicle accidents and reduced market demand made loan repayment unmanageable. His

experience emphasizes the need for sector-specific risk mitigation strategies, such as insurance coverage and contingency planning. Likewise, Mr. Khadka's restaurant business suffered due to misaligned financial priorities, where investing in real estate rather than business improvement ultimately led to its closure.

These case studies reinforce key recommendations for financial institutions, policymakers, and SME owners:

- a. Strengthening financial literacy programs to help entrepreneurs manage funds effectively.
- b. Enhancing loan monitoring mechanisms to prevent misallocation of borrowed capital.
- c. Developing sector-specific loan products that include risk-mitigation components like insurance.
- d. Encouraging digital tools and strategic reinvestment to maximize business growth.

By addressing these areas, SME loan effectiveness can be significantly improved, reducing default rates and fostering long-term economic sustainability in Mahendranagar and similar regions.

Results and Discussion

The analysis of SME loan utilization in Mahendranagar reveals critical insights into the opportunities and challenges faced by entrepreneurs. The findings are derived from the case studies, surveys, and interviews conducted during the research. They shed light on key patterns in loan management, financial literacy, sector-specific risks, and the effectiveness of existing policies. Below are the primary findings of the study:

Loan Misuse Remains a Persistent Issue

Approximately 40% of SMEs in Mahendranagar diverted loan funds for purposes other than business development. The case of Mr. Sharma, who redirected funds meant for expanding his retail business to cover personal expenses, is a common example. Such misuse often stems from financial pressures outside the business and a lack of clear boundaries between personal and business finances. Loan misuse directly affects repayment capabilities, leading to defaults and strained relationships with lenders.

Financial Literacy Gaps

A lack of financial literacy is a significant barrier to effective loan utilization. Many SME owners struggle with basic financial management tasks, such as budgeting, cash flow forecasting, and record-keeping. This is evident in cases like Ms. Bista, who lent part of her business loan informally, resulting in financial instability. Entrepreneurs often lack the knowledge to evaluate risks or make informed decisions, highlighting the urgent need for targeted financial training programs.

Challenges in Risk Management

External risks, such as market fluctuations, operational failures, and unforeseen events, severely impact SME performance. The transport business owned by Mr. Raut demonstrates how accidents and insufficient insurance coverage can destabilize an otherwise promising enterprise. Many SMEs do not have contingency plans or adequate risk mitigation strategies, leaving them vulnerable to disruptions. This underscores the need for sector-specific financial products that address unique risks, such as weather-related issues for agriculture or equipment insurance for transportation.

Positive Impact of Disciplined Loan Utilization

SMEs that adhered to their loan objectives and invested strategically in business growth achieved remarkable success. The example of Ms. Thapa's boutique highlights how financial discipline, coupled with a clear business plan, can lead to significant revenue growth and sustainability. Entrepreneurs who utilized loans for productive purposes, such as upgrading equipment or expanding inventory, not only improved their financial standing but also enhanced their creditworthiness, enabling further access to financing.

Sector-Specific Challenges

Each industry faces unique challenges that influence loan utilization and business outcomes. In retail, issues like inventory mismanagement and competition from larger outlets are prevalent. Agriculture businesses, like that of Ms. Bista, often encounter risks from weather uncertainties and fluctuating market prices. The hospitality sector, represented by the case of Mr. Khadka, requires continuous investment in quality and customer experience, which many fail to prioritize due to misaligned financial goals.

Weak Monitoring Mechanisms

Loan monitoring remains a critical gap in the financial ecosystem. Despite guidelines from Nepal Rastra Bank mandating quarterly reviews for working capital loans, many banks lack the manpower or technological tools to ensure compliance. This has allowed loan misuse to persist, as seen in multiple case studies. Improved monitoring systems, such as digital tools and periodic audits, are essential for ensuring accountability and effective fund utilization.

Limited Awareness of Policy Provisions

While Nepal Rastra Bank has introduced several supportive policies, including interest subsidies and collateral-free loans, many SMEs are unaware of these benefits. This lack of awareness prevents entrepreneurs from leveraging available resources, further exacerbating challenges in accessing affordable credit. Financial institutions also face difficulties in effectively communicating and implementing these policies at the grassroots level.

Role of Digital Tools in Business Success

The study found that SMEs utilizing digital tools, such as social media marketing and digital payment systems, were more likely to achieve sustainable growth. For instance, the boutique owned by Ms. Thapa leveraged online platforms to expand its customer base, demonstrating the potential of technology to enhance business performance. However, the adoption of such tools remains limited due to infrastructure challenges and low digital literacy among SME owners.

Overextension and Debt Management

Some SMEs overextend themselves by taking on excessive debt without fully evaluating repayment capacities or market conditions. The transport business owned by Mr. Raut is a clear example of how over-reliance on loans can lead to financial distress. Effective debt management practices and a more cautious approach to borrowing are necessary to prevent similar outcomes.

Need for a Collaborative Ecosystem

The findings emphasize the importance of collaboration between financial institutions, government bodies, and local organizations. Joint efforts can address gaps in financial

literacy, risk management, and policy awareness, creating a supportive ecosystem for SMEs. For instance, partnerships could enable the development of tailored training programs and sector-specific financial products that align with the unique needs of Mahendranagar's businesses.

Conclusion

Small and Medium Enterprises (SMEs) are a critical pillar of Nepal's economy, particularly in Mahendranagar, where they contribute significantly to employment and entrepreneurship. However, this study finds that their growth is hindered by key challenges such as loan misuse, financial illiteracy, and weak risk management strategies. The findings indicate that a collaborative approach among financial institutions, policymakers, and SME owners is essential for improving loan effectiveness. By implementing structured financial education, digital monitoring systems, and sector-focused financial products, SMEs in Mahendranagar and beyond can achieve greater financial stability and long-term economic contribution. This research provides a foundation for future policy improvements, enabling more sustainable SME financing models across Nepal. To improve SME financing in Mahendranagar and similar regions, targeted interventions must address loan misuse, financial literacy gaps, and sector-specific challenges.

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