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Evaluating Consumer Creditworthiness in Nepal: Mechanisms, Gaps, and Reforms

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Abstract:

This paper explores how consumer creditworthiness is measured in Nepal, what are the current gaps, and how the policy can be reformed to promote financial stability and inclusion. Although there is an improvement in opening up access to finance, credit worthiness in Nepal is more of a collateral and income-based assessment with little regard on borrowers' repayment history. The increasing non-performing loan (NPL) ratio 1.3 per cent in June 2022 to 3.9 per cent in FY 2023/24 is an indication of the increasing credit risk under the current practice. The study sampled 150 loan officers in 20 A-grade commercial banks in Kathmandu, Lalitpur, Bhaktapur, Chitwan and Pokhara using a mixed-method design, where primary data was collected. The secondary data were recorded using structured questionnaires and interviews and also through Nepal Rastra Bank reports and bank publications. The analysis was done through thematic interpretation and further through the data analysis using MS Excel and SPSS. The findings indicated that although 95 percent of banks will check credit history before issuing approval, 19 percent do not have standard systems. The key obstacles are the verifying informal income (34%), poor documentation (28%), and the high cost of field verification (15%). As well, uneven income, poor misappropriation of funds, and poor monitoring were stated as the major causes of defaulting small loans. The article concludes with the necessity of an obligatory credit rating system, default reporting, and digital KYC. The effect of such reforms will be the reduction of default risks, encouragement of responsible lending, and the establishment of trust in the banking sector in Nepal. Enhancing credit governance is thus crucial towards sustainable economic growth and inclusive growth.

Keywords: Consumer Creditworthiness, Credit Risk, Non-Performing Loans, Credit Reporting System, Nepal

Introduction

The Nepal banking industry is very vital in the provision of financial services, especially credit to consumers and the small business. Nevertheless, the present-day system of consumer credit evaluation in Nepal is inadequately developed when opposed to the requirements of the developed economy in the context of which the effective credit scoring and reporting systems are obligatory (Gole & Thagunna, 2022). Collateral and income verification are the inseparable factors used by most banks instead of comprehensive consumer credit histories (Pandey et al., 2022). This makes inefficiencies, default risk, and curtail the financial inclusion (Nepal, 2023). In this research, the researcher is going to examine the existing consumer credit checking systems in Nepal, find out the prevailing gaps in the system and suggest policy improvements to enhance the system (Humagain, 2023) to promote better credit assessment and reduce default risks (Sigdel & Deswal, 2024). This study aims to align Nepal's practices with global standards, ensuring more effective financial inclusion and risk management in the banking sector.

Research Problem

Lack of a standardized credit rating system in Nepal has brought about a huge gap in the financial sector of the country. Assessment of consumer credit history is not a regular exercise by most banks during the processing of loan applications which means that assessment is done unevenly and that the banks have little understanding of how the borrowers will repay the loans (Bhandari, 2023). This is a weakness in credit risk management and the establishment of a clear and credible lending environment. Further, the default reporting mechanisms have dramatic flaws. Nepal does not have a fully functioning centralized system, which will capture and distribute monthly repayment default that is available in all banks (Khanal, 2022). This drawback does not allow the financial institutions to get a total picture of the performance of a borrower in the past thus creating recurrent lending to high-risk persons and creating systemic vulnerabilities within the banking sector (Risal & Poudel, 2020).

This has resulted in increased risks of loan defaults by the banks especially with small and unsecured loans. Their inability to identify creditworthy and non-creditworthy borrowers is limited by the lack of compulsory credit checks (Ahmed et al., 2023). This is not only disastrous to the stability of individual institutions but also to the confidence of the population in the larger financial system (Pradhan & Shah, 2019). To overcome these problems, the immediate solution is reform of the regulations that would introduce the concept of credit history evaluation mechanisms (Khanal, 2022). The establishment of the compulsory credit rating in the form of mandatory practices used in the world like Equifax or Experian would improve risk assessment, decrease non-performing loans, and promote consumer confidence. The development of such a structure can be extremely important in updating the credit infrastructure in Nepal and providing increased financial stability.

Research Objectives

1. To examine the way Nepalese banks, measure the practicality of consumer credit.
2. To measure the accessibility and utilization of credit history and default reporting provisions.
3. To quantify the risks and default trend of small loans in Nepal.
4. To propose a functional model on the compulsory check of credit history, based on international experience.

Research Questions

1. Are Nepalese banks following a standardized method of screening consumer credit history during loan application?
2. Do loan defaults on repayments get reported and incorporated into the future credit decision?
3. What is the default rate of small loans in Nepal and what are the risks of this to the banks?
4. Which viable changes, based on global credit rating systems, can Nepal implement to enhance consumer credit evaluation?

Methodology

Our universe is a sample of loan officers working in 20 A-grade commercial banks within Nepal, in central and semi-central areas such as Kathmandu, Lalitpur, Bhaktapur, Chitwan and Pokhara. These areas were selected as they are the most active financial areas in the country where the most prevalent are the retail and small-scale lending. In these banks, branches were chosen randomly on a sampling basis to avoid biases on the institutional and geographical differences (Jaisi et al., 2024). One loan officer was selected through the use of a proportional sampling method in each of the selected branches so that there was a total of 150 respondents in 30 branches in each district.

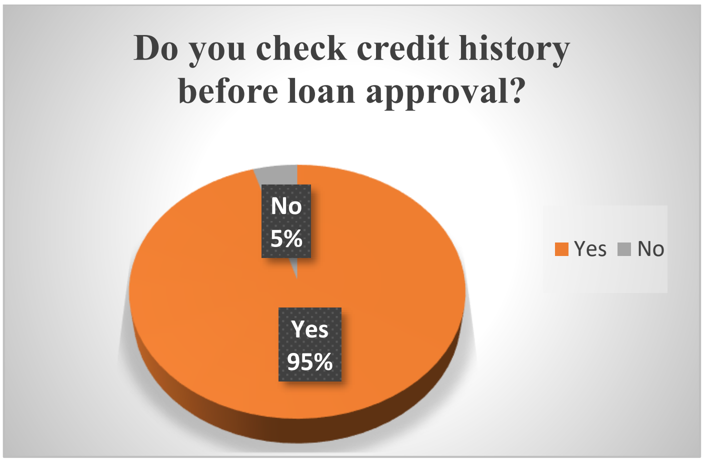
Firsthand information was gathered by the use of structured questionnaires and interviews with data collection strategies primarily based on personal information gathered by employee of the loan department and department heads. Bank officials and loan officers were also interviewed extensively to obtain qualitative information on operations issues, risk perceptions and gaps in procedures in small-loan evaluations (Pant, 2023). To enhance the validity of results, primary data were triangulated and complemented with secondary data in the form of annual reports of the Nepal Rastra Bank and individual commercial banks. The analysis involved the qualitative and quantitative approach (Gyawali & Acharya, 2023). Thematic analysis was used to review the key issues in the assessment of small-loan and to find repetitive causes of small-loan default, which have been interpreted by hand to identify the contextual subtleties. The questionnaire data, whether quantitative or not, were inputted in the questionnaire and processed and analyzed using MS Excel and SPSS software and the visual data were created using MS Excel 2025 to demonstrate trends and relationships (Bhatt, 2025) to the data collected. This approach not only allows for a comprehensive understanding of loan default trends but also informs future policy recommendations for improving lending practices in Nepalese banks (Bhandari, 2022).

This study is limited to consumer loan up to NPR 1 crore because the loans are the most frequently issued consumer loans in which no strict assessment and documentation procedures are enforced. Through this loan segment, the research will pinpoint a lack of system efficiency in risk rating and will offer evidence-based policy suggestions to enhance the governance of the small loan segment of commercial banking in Nepal.

Results

Verification of History of credit before loan approval among loan officers.

Figure 1: Credit History Checking Among Loan Counters Before Loan Approval.



In figure 1, the researcher shows the reaction of 150 loan officers to the query of whether they look at credit history before issuing loans. Among all the respondents, 95% of them said that they check the credit history of the borrower before sanctioning the loan and the remaining 5 percent said that they do not. This massive majority shows that the majority of commercial banks in Nepal have incorporated checking of credit history in their routine lending practices. Nevertheless, its low percentage of officers who do not follow this step points to the still existing inconsistencies in the processes, and that policies should be followed with consistency, and that tighter controls over regulatory processes are necessary to bring about responsible lending habits among all institutions.

Existence of Standardized Credit Check Systems in Nepalese Banks

Figure 2: Existence of Standardized Credit Check Systems in Nepalese Banks

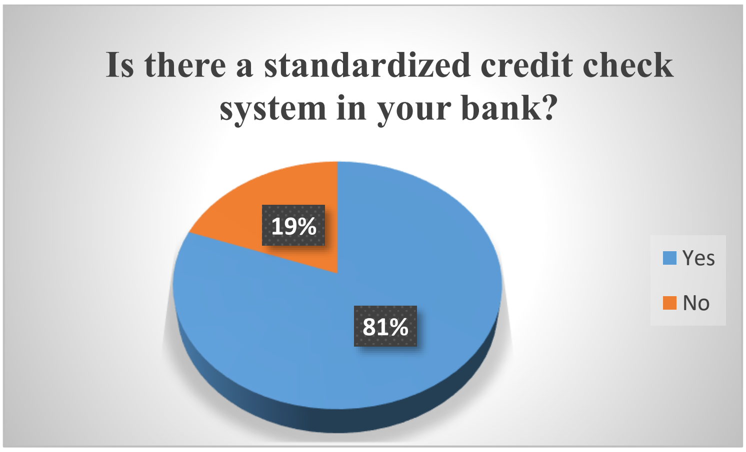


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Figure 2 shows that standardized credit check systems have existed in the Nepal commercial banks according to the responses of 150 loan officers. The findings reveal that eighty-one percent of the sample population affirmed that they had a standardized credit check policy in their organizations, and one in five stated they had none. This is to show that despite the fact that formalized credit evaluation procedures have been adopted by most banks, a considerable percentage of banks still use manual or inconsistent practices. The fact that almost one-fifth of the banks lack standardized systems demonstrates that the changes in regulations and technological adoption are necessary to guarantee the consistency and transparency of credit risks evaluation system throughout the sector.

Reporting of Repayment Defaults to a Centralized System

Figure 3: Reporting of Repayment Defaults to a Centralized System

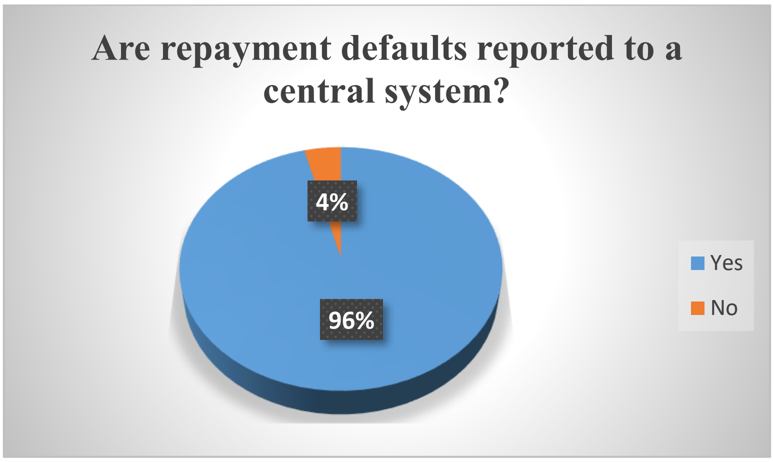


Figure 3 depicts the reporting loan default on repayment to central mechanism at Nepalese commercial banks. The results have shown that an insurmountable majority of the respondents (96% affirmed), that defaults in repayment are reported to central monitoring system whereas only 4% affirmed that they do not do so in their institutions. This indicates that the majority of the banks are in line with the regulatory requirements to disclose the default information, which is probably in the form of mechanisms that the Credit Information Bureau (CIB) of Nepal oversees. Nevertheless, the few banks who did not record defaults emphasize the necessity to enforce them more and fully digitalize the system so that the credit risk could be tracked on a large scale, covering the whole banking system.

Consideration of Past Repayment History in New Loan Applications

Figure 4: Consideration of Past Repayment History in New Loan Applications

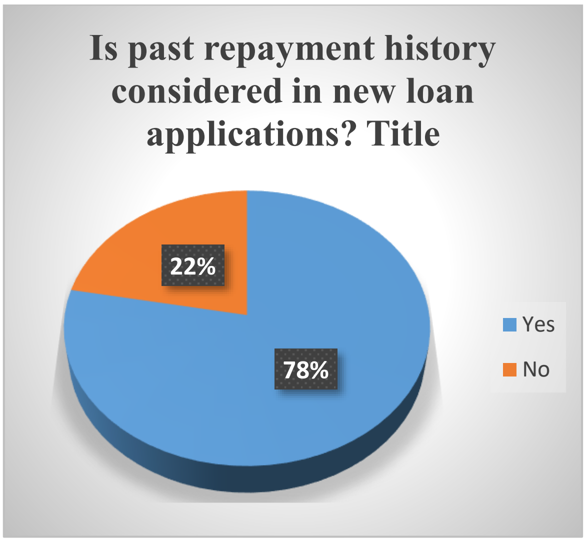


Figure 4 indicates how much past history of the repayment is taken into consideration when new loan applications are being evaluated by the Nepalese commercial banks. The statistics show that 78 percent of the loan officers consider previous records of repayment when making new loans and 22 percent said that they did not necessarily check such history. This implies that their viewpoints are that most banks are aware of the significance of credit behavior of a borrower when determining loan eligibility, however, there is a significant number of borrowers that do not consider such an important aspect. The insufficient focus on the repayment history may result in the repetition of lending to the high-risk borrowers, which explains the necessity of the standardized credit assessment systems throughout all the institutions.

Credit Checks for Loans Below NPR 1 Crore

Figure 5: Credit Checks for Loans Below NPR 1 Crore

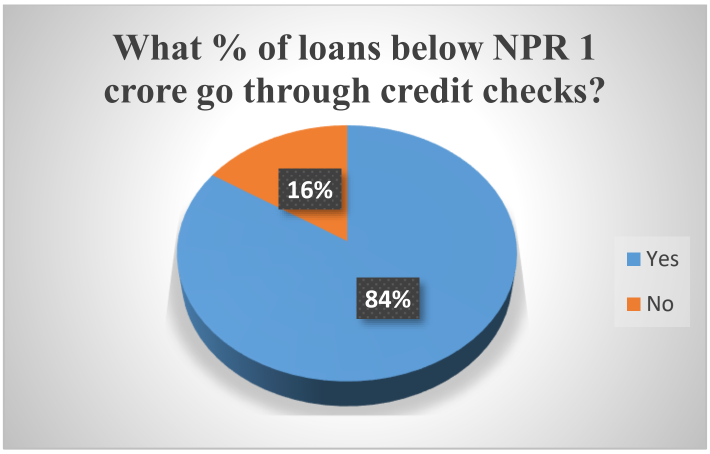
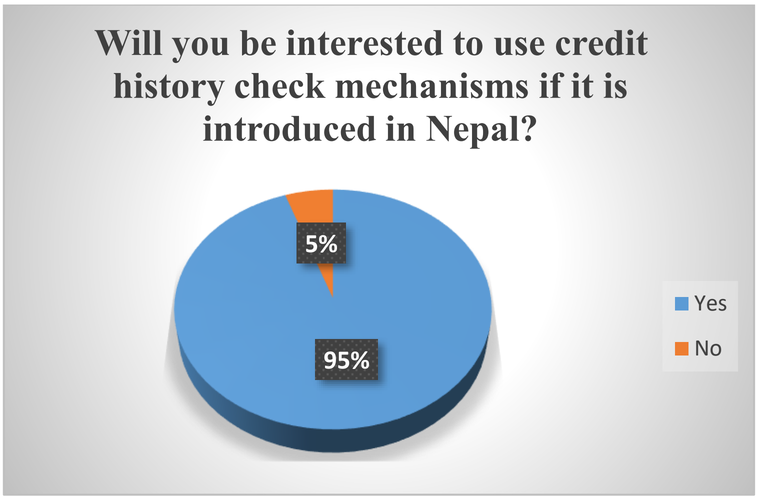


Figure 5 shows the percentage of loans with lower values less than NPR 1 crore that are subjected to credit checks before authorization. Majority of the responses returned by 150 respondents who were loan officers showed that 84% of the banks they work in carry out credit checks on even small loan amounts and 16% indicated that the banks they work in do not always carry out credit checks. This observation presents a healthy trend that is inclined towards better credit governance among most commercial banks in Nepal.

Interest in Using Credit History Check Mechanisms if Introduced in Nepal

Figure 6: Interest in Using Credit History Check Mechanisms if Introduced in Nepal



As illustrated in Figure 6, the degree of interest among loan officers in becoming formal credit history check systems in case the systems were implemented in Nepal is high. The statistics demonstrate that the majority of the respondents 95% were willing to use standardized credit history tools, with only 5% showing that they were not interested. This highly favorable attitude is an indication that the banking industry has appreciated the need to carry out systematic credit appraisal to minimize default risks and increase the efficiency of lending.

Table 1: Quantification of Main Challenges in Small Loan Assessment

S.N.	Category of Challenge	Representative Statements from Respondents	Frequency (out of 150)	Percentage (%)	Interpretation
1	Verifying Informal Income and Cash Flow	"The main challenge in small loan assessment is verifying informal income and cash flows." / "Accurately evaluating repayment capacity when formal financial records are limited or unavailable."	51	34%	This was the most frequently mentioned challenge. Many small borrowers operate informally without financial statements, making it difficult to assess their repayment capacity objectively.
2	Inadequate Documentation and Limited KYC Information	"Inadequate documentation and limited KYC information hinder accurate risk assessment." / "Lack of proper documents affects fair appraisal."	42	28%	Poor documentation and incomplete customer identification remain major barriers to reliable loan appraisal. This weakness undermines compliance and increases credit risk.
3	Costly and Time-Consuming Field Verification	"Field verification is costly and slows down appraisal timelines for small tickets." / "Field verification delays approval process."	23	15%	On-site verification is necessary for informal borrowers but significantly increases operational costs and turnaround time, particularly for small loan amounts.
4	Lack of Credit History or Past Borrowing Record	"Borrowers often lack credit history, making probability of default estimates uncertain."	15	10%	Many small borrowers are first-time clients with no formal credit record, limiting the effectiveness of traditional credit scoring and risk modeling.
5	Limited Staff Capacity and Competing Priorities	"Limited staff capacity and competing priorities reduce time for detailed assessment."	12	8%	Credit officers are often overloaded with multiple responsibilities, which reduces the depth and quality of their appraisal and risk evaluation.
6	Other Operational or Contextual Issues	"Different customers and marketing." / "Matching financial analysis benchmark." / "Cost are same."	7	5%	A small number of responses mentioned unique, institution-specific challenges such as fixed operational costs, benchmarking difficulty, and customer diversity.

Out of 150 responses, two issues that were identified the most (34 and 28 percent, respectively) are relevant to confirming the informal income and cash flows and insufficient documentation and KYC information. It brings out the point that the main limitation of small-loan evaluation is information asymmetry because the financial institutions are unable to gather valid data on the borrowers. The second important obstacle is the expensive field verification (15%), and this struggle indicates the un-efficiency of the manual process when it comes to small-ticket loans. Other moderate issues are the unavailability of borrower credit history (10%), insufficient staff as it is a hindrance to accurate evaluation. A small part (5%) of the participants mentioned situation-specific operational issues, including cost structure and heterogeneous customer behavior. In general, the results indicate that, with better data availability, documentation, and digital verification mechanisms and increased capacity to improve the staff, the accuracy, efficiency, and fairness of the small-loan appraisals in Nepalese financial institutions would be significantly enhanced.

Thematic Analysis of Main Challenges in Small Loan Assessment

Theme 1: Difficulty in Verifying Informal Income and Cash Flow

Codes: *"checking informal income and cash flows," "properly assessing the repayment capacity," "no or restricted financial records," "reliability of income source."*

One of the prevailing trends based on the data is the issue of ensuring that the stream of incomes of the borrowers is real. There are numerous responses where the participants pointed out multiple times that the primary difficulty of the small loan assessment lies in the process of checking the informal income and cash flows. Officers gave examples of small traders or informal entrepreneurs who carry out their businesses without any written records, receipts, or organized accounts. In this situation, loans have to be based on verbal estimates or self-reported values which are not reliable. This is an even bigger problem where the borrowers earn variable income or rely on seasonal markets. Respondents indicated that restricted documents and unofficial business operations are some of the difficulties when it comes to conducting a reasonable credit examination. Such inability to measure cash flow using objective methods leads to subjective assessment and high levels of uncertainty in the estimate of the repayment capability. This theme also shows how structured the small business sector of Nepal is that much economic activity takes place outside the formal financial reporting framework and loan officers have to make use of their gut instinct as opposed to hard data.

Theme 2: Inadequate Documentation and Limited KYC Information

Codes: *"inadequate documentation," "limited KYC information," "lack of proper documents," "documentation and nature of business in small market," "documentation with credit awareness."*

The second significant theme is lack of documentation and poor identification of customers. Many of the respondents noted that poor documentation and insufficient KYC data are impediments to proper risk assessment. Loan files do not have the important financial documents, ownership certificates, or verification papers that are vital in compliance. Borrowers in rural or semi-formal businesses do not know the significance of record keeping resulting in submission of unfinished applications. This, the officers associated with a larger ignorance of credit among small clients, who view documentation as an unnecessary form of bureaucracy, and not a security measure. This issue also sparks to the institutional processes, some of the respondents stated that the nature and documentation of business in small markets poses a challenge to establish authenticity or find a cross-check between data. Manual records are usually inconsistent or lost without standardized form or digitized storage. This theme demonstrates that documentation gap is a significant hindrance to effective and open appraisal of loans in cooperatives and microfinance institutions.

Theme 3: High Cost and Time Burden of Field Verification

Codes: *"field verification is expensive and lowers down the appraisal schedules," "field verification delays small tickets," "cost are same."*

The high cost and logistical challenge of field visits was a common operational constraint that was reported by the respondents. The term field checking is expensive and wastes time when carrying out appraisal. According to officers, it is necessary to visit businesses or households physically to verify income, collateral and ownership of small borrowers who do not have paperwork, but it is disproportionate in resource and time use. Since verification costs are relatively constant irrespective of the amount of loan, the respondents observed that, cost are same even when the loan is very small, which makes the profitability even less desirable. This theme indicates that there is a structural weakness in the existing appraisal models given that the human checking is the only plausible method of certifying information. The respondents suggested that the digital solution can be used to cut these costs and still maintain due diligence standards, i.e., mobile verification tools or digital mapping.

Theme 4: Lack of Credit History and Reliable Financial Benchmarks

Codes: "*borrowers typically have nonexistent credit history," "the chances of default are unestimated," "the matching financial analysis benchmark."*

The other powerful theme is connected with lack of credible credit history among small borrowers. Respondents noted that probability of default estimates is usually not certain because of lack of credit history amongst borrowers. In the absence of past borrowing history, it becomes hard to determine creditworthiness or use predictive scoring models. This absence of historical data of which the officers cited that it nullifies benchmarking: this is because it is very difficult to equal the benchmark of financial analysis when the borrower has never been within the formal banking system. Such absence of credit trail causes subjective appraisal of personal impressions or reputations of the area, which contributes to moral hazard. The theme highlights the necessity to have a national level credit information system, which includes micro and cooperative borrowers, in order to provide fair access to finance and risk-linked pricing.

Theme 5: Institutional Constraints and Staff Capacity Limitations

Codes: "*limited staff capacity and competing priorities," "reduce time on in-depth assessment," "financial appraisal," "different customers and marketing."*

Some of the answers indicate organizational issues within the company and not the borrower related problems. Officers explained that there is less time to conduct a detailed assessment due to the limited capacity of staff and conflicting priorities. Most cooperatives and small banks have one officer who serves more than one role such as customer relations to loan documentation which restricts the attention given on the cases. The respondents reported that workloads and lack of training inhibit their capacity to do effective conduction of financial appraisal. The rest cited different customers and marketing to refer to the hardness of dealing with different client groups with different needs and risk profiles. This theme brings out the human resource aspect of loan evaluation, making it appear that the better knowledge of staff and their management of the workflow is as good as the technological reformation.

Interpretation

In all themes mentioned, there is the primary line that is shared, and it is the issue of information asymmetry as it exists between borrowers and lenders. Officers do not have enough, verifiable information that can be used to determine the capacity to repay the loan, and thus must resort to their own judgment and manual verification that is expensive. This gap in the system is addressed by the codes, which include, but are not limited to, verifying informal income, inadequate documentation, and field verification is costly. The focus of the respondents on lack of credit history of the borrowers and inadequacy of staff capacity indicates both external and internal limitation of proper risk assessment. The thematic results also correspond well with the general financial inclusion studies, the main idea of which is that the effectiveness of small-loan programs lies in finding a balance between access and due diligence. Digital KYC, mobile-based income tracking, and training of staff in the data-driven appraisal are institutional innovation that can help fill much of these gaps in Nepal context. Nevertheless, the human factor is still at the center of focus; technology cannot be used to evaluate credit fairly, as it will always take up judgment, morals, and communication between lenders and borrowers.

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Table 2: Results of Most Common Reasons for Small Loan Default

S.N.	Category / Theme	Representative In-Vivo Codes from Responses	Frequency (out of 150)	Percentage (%)	Interpretation
1	Irregular Income and Weak Cash Flow Management	"Irregular income and seasonal earnings lead to missed installments," "reduce in repayment capacity," "depends on seasonal income," "weak financial discipline and poor cash flow management."	45	30%	The most frequently mentioned cause of default. Borrowers' income is seasonal and inconsistent, leading to liquidity shortages and delayed or missed repayments.
2	Weak Post-Disbursement Monitoring and Credit Supervision	"weak post disbursement monitoring allows early warning signs to go unnoticed," "poor and negligence on credit risk analysis."	30	20%	Limited follow-up and weak supervision prevent early identification of repayment problems, allowing minor issues to become defaults.
3	Misuse or Diversion of Loan Funds	"misuse of fund," "loan taken for business used for purchase of land," "capital injection in other sectors," "diversion of fund for personal use."	23	15%	Borrowers often divert loan funds to non-productive or personal uses, disrupting business cash flow and reducing repayment capacity.
4	Overestimation of Business Cash Flow at Appraisal Stage	"business cash flows were overestimated at appraisal stage," "poor credit analysis," "not prepare analysis of 5C," "ignorance of components of 5Cs."	20	13%	Inaccurate financial projections and poor application of credit appraisal frameworks (5Cs) cause approval of loans beyond actual repayment capacity.
5	High Cost of Living and External Economic Factors	"high living costs and inflation reduce repayment capacity," "external factors i.e. political and economic condition of the country," "market slowdown."	18	12%	Inflation, market contraction, and political instability reduce income and increase household expenses, making timely repayment difficult.

S.N.	Category / Theme	Representative In-Vivo Codes from Responses	Frequency (out of 150)	Percentage (%)	Interpretation
6	Borrower Behavioral Factors and Poor Repayment Discipline	“borrowers tend to reprioritize expenses over loan repayment during shocks,” “non-regular repayment,” “lack of financial discipline.”	14	10%	Some borrowers display low financial discipline, postponing loan repayment when income falls or prioritizing other personal expenses.

The response analysis of 150 to the questions on the causes of small loan default has shown that the main reasons of repayment troubles are a mix of fluctuation in income, poor institutional supervision, and mismanagement of borrowed money. The most prevalent cause of default according to the largest proportion of respondents (30 per cent) was irregular income and poor cash flow management. A large number of small borrowers rely on seasonal or variable sources of income, like agriculture or petty trade, and it is hard to sustain cash flow and regular schedule of installments. Another 20 percent of the respondents linked defaults to poor after disbursement monitoring and credit oversight. They highlighted that poor follow up and absence of early warning signals allows repayment issues to turn into defaults. Approximately, 15 percent of the respondents cited misuse or diversion of loan funds whereby borrowers spent the borrowed funds in non-productive or personal activities instead of using the funds to run business activities, thus causing disrupted cash flow and failure to make repayments.

Other significant yet less prominent factors were the overestimation of business cash flow in the process of loan appraisal (13%), which is an indicator of vulnerability of credit assessment and the employment of the 5C framework; high living expenses and unfavorable economic or political conditions (12%), which diminishes disposable income and influences the capacity of the borrowers to repay their loans during financial distress; and poor financial discipline or behavioral factors (10%), which includes the borrowers prioritizing other areas of expenditure over loan repayment. Collectively, these results reveal that small loan defaults among Nepalese financial institutions have been caused by the weakness of both the borrower and the institution. Although irregular income and misuse of funds are indicators of borrower-side vulnerability, poor monitoring systems, false appraisal, and financial illiteracy are indicators of systemic weaknesses in lending practices. The general trend highlights the necessity to enhance credit appraisal procedures, constant oversight of borrowers, and intensified financial education to establish repayment discipline and resistance to external economic tumults.

Thematic Analysis: Most Common Reasons for Small Loan Default

Theme 1: Irregular Income and Weak Cash Flow Management

Codes: *"irregular income, seasonal earnings," "poor cash flow management," "weaken in terms of loan repayment," "weaken in terms of income," "relies on seasonal income."*

The most evident theme in all responses is the volatile income of the borrowers and poor management of cash flow. A good number of the respondents wrote that, due to irregular income and seasonal earnings, installments are missed and that the ability of borrowers to pay is lower when their incomes decrease. Small borrowers, especially the micro-entrepreneurs, depend on agriculture, trading or manual labor, which not only vary with market cycles and seasons but also daily labor demands. Some members of the group shared the reason that "a lot of the small borrowers are relying on the seasonal income and they are not keeping the proper records. Slowing of business or delayed payment by customers leads to liquidity crunch amongst the borrowers and displays them to repayment schedules. Insufficient financial planning was also highlighted by the respondents with poor cash flow management being another significant factor that led to default. Low levels of savings, lack of reserve funds and over reliance on short term turnover makes borrowers incapable of absorbing economic shocks. This trend demonstrates that not all defaults occur because of the lack of willingness to pay but rather it is a consequence of the weak financial framework of small businesses.

Theme 2: Misuse or Diversion of Loan Funds

Codes: "*misuse of fund," "loan taken to start business and spent in acquisition of land," "capital injection in other sectors and diversion of funds to personal use."*

The second prevalent theme is the abuse of loan funds, which can be used in other ways that were not mentioned in the loan proposal. Most of the officers have said that misuse of fund was a common thing where business loans were forced into personal consumption, family spending or speculative investments. One of the answers said bluntly that business loans that are obtained are utilized to buy land. This malpractice discontinues the normal cycle of cash flow and is one of the direct causes of repayment delays. The interviewees noted that lack of close monitoring gives way to redirect capital by the borrowers which destroys the business viability and discipline in repayments. This theme brings out the behavioral and ethical aspect of default in which poor borrower accountability and weak instability follow-up interact.

Theme 3: Weak Credit Appraisal and Monitoring Practices

Codes: "n*ot prepare analysis of 5Cs," "ignorance of any of the part of 5Cs," "overestimation of business cash flows at the appraisal stage," "weak post disbursement monitoring," "poor and negligence on credit risk analysis."*

A number of the respondents identified institutional weaknesses as the root cause of default. A basic instrument to credit risk assessment is the 5C framework character, capacity, capital, collateral and condition. Nonetheless, respondents acknowledged that their organizations tended to fail to prepare the analysis of 5C or disregard some of the elements. This laxity causes loans to be given without sufficient analysis of the risk of borrowers. Additionally, there were numerous answers of business cash flows being overestimated at the stage of appraisal and a poor monitoring after disbursement to enable early warning signals to be detected. This kind of comments indicates that despite the initial analysis being carried out, follow-up procedure is poor. The officers do not realize early signs of distress like lack of sales or turnover before defaults are experienced.

Theme 4: External and Economic Factors

Codes: "*external factors i.e. political and economic condition of the country," "high living costs and inflation lower repayment capacity," "market slow down, emergency expenses."*

Quite a high number of respondents acknowledged external shocks to trigger the default of small loans. The macroeconomic setting, which is characterized by inflation, volatile demand in the market, and political insecurity, has a direct effect on the repayment ability of small borrowers. One officer mentioned that high cost of living and inflation decrease the ability to repay, and another one mentioned political and economic situation in the country as the major causes of non-performance. Micro-traders and farmers working with borrowers are especially susceptible to external shocks like droughts, transport strikes or price fluctuations. There is also the problem of emergencies such as sickness or family problems that shift the income towards repayment. This theme reveals the interrelation between environmental and economic volatility and structural informality to continue with default threats, which are not always within the control of the borrower.

Theme 5: Weak Borrower Discipline and Behavioral Factors

Codes: "*non regular repayment," "prioritize expenses over loan repayment in the shocks," "weak financial discipline," "rely on the seasonal income," "ignore repayment when income falls."*

The other theme that has been played relates to the behavioral aspect of the financial discipline, repayment of default borrowers and prioritization of expenses. A number of the officers said that borrowers will repriorities its expenditure over their loan payment when they experience a shock, that is, as the costs of the homes or businesses rise, debt repayment is given a lower priority. There were other labels as weak financial discipline and non-regular repayment habits. Other respondents also stated that most of small borrowers are lacking knowledge on credit discipline and see repayment as a voluntary thing instead of a compulsory move. Moral hazard may also be increased in certain instances through social acquaintance between the borrowers and cooperative employees, which decreases the incentive to repay on time. This theme brings emphasis on the role of financial literacy and sensitization of borrowers towards creation of a repayment responsibility culture.

Interpretation

A combination of these themes demonstrates that the default of small loans among Nepali banks and cooperatives is caused by both structural and behavioral factors. Lack of regular income, poor cash flow management and poor documentation make it financially fragile whereas misuse of funds and poor monitoring are the signs of institutional and ethical failures. In the meantime, the external factors like inflation, political instability, etc. make the already existing vulnerabilities even worse. In a consistency of responses, the most common in-vivo codes of irregular income, weak post-disbursement monitoring, misuse of fund, and behavioral indiscipline caused default, and this way of causality is consistent throughout responses. The results indicate that solutions to loan default should be based on better credit analysis and comprehensive borrower interaction, enhanced post-disbursement control as well as contextual policies taking into account market fluctuations and livelihood trends of the borrowers.

Discussion

According to the results of this paper, the banking sector in Nepal is still in the phase of transition between the traditional and collateral-based lending and the modern data-driven credit assessment model. Even though credit history is checked by 95 percent of the loan officers prior to loan approval, the lack of a universal credit rating system among all institutions means that credit rating habits are not uniform (Kattel, 2017). This difference compromises the precision of risk profiling, and the banks are subjected to rising non-performing loan (NPL) ratios, which has soared tremendously over the years. The fact that the majority of the issues were connected to verifying informal income (34 percent) and poor documentation (28 percent) indicates that the problem of information asymmetry is the key obstacle to effective credit evaluations (Dhami, 2025). The thematic analysis of the study also showed that the institutional inefficiencies include the costly field checks and the insufficient capacity of staffs that inhibit the scalability and sustainability of loan analysis. In addition, there are behavioral and structural conditions such as low borrower discipline, income sporadicity and embezzlement of funds that increase the risk of small-loan defaults (Mueller et al, 2019). Such results are consistent with previous research that indicates that the credit ecosystem of Nepal does not have any powerful data integration and regulatory execution tools (Lu et al, 2023). In turn, these systemic issues require integration of extensive policy changes and introducing new technological measures to increase the accuracy of the data, the efficiency of operations, and regulatory control in the microfinance industry (Halleux et al, 2020). The high desire (95) by loan officers to implement standardized credit-check systems is a sign of the sector being willing to be reformed. Thus, it is critical to introduce an obligatory credit rating system, digital KYC, and a central default-reporting system (Brito et al, 2009) (Yan, 2019). This kind of reform would standardize the assessment processes, minimize manual inefficiencies and ensure that there is some sense of accountability and transparency. Finally, by improving the credit governance by systematic reforms, the reduction of loan defaults, as well as the promotion of financial stability and inclusive economic development in the banking industry of Nepal, will be achieved (Gong et al, 2020).

Conclusion

This paper has been a thorough evaluation of the processes of consumer credit worthiness in Nepal and identified some of the key gaps as well as given out reforms to the existing credit worthiness system that would be more efficient and transparent. The results indicate that most business banking institutions do fundamental credit checks, but there is no uniformity in the way these checks are conducted, and such inconsistencies in reporting methods compromise the validity of risk assessment. In Nepal, credit evaluation is largely collateral based and there is low use of repayment history of the borrowers or behavioral factors. The challenges noted are problems with verifying informal sources of income, poor documentation, and field verification is very expensive and time-consuming as well as limited staff capacity. All these weaknesses heighten chances of loans default especially in small and unsecured loans. The importance of this study is its contribution to policy and practice. In the case of banks, it can give them practical information on how standardized credit assessment can benefit portfolio quality and exposure to risk. To the borrowers, it provides a more equitable access to credit according to financial conduct as opposed to the security or other personal influence. To the economy, it enhances financial stability, trust and inclusion because it will streamline the Nepalese credit practices to international standards. A national credit rating and reporting system will not only bring modernization in the financial sector but also help instill a spirit of responsibility, transparency and fair use of credit and thus meet the other broader aims of sustainable economic development in Nepal.

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