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RETAIL LOAN UNDER INTEREST RATE FLUCTUATION IN NEPAL: COSTUMERS' INTEREST, CHALLENGES AND MANAGERIAL SOLUTIONS

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ABSTRACT

Globally, interest rates play an important role in banking loans for all types of customers. In the present context, the banking sector is growing in Nepal. Banking sector is being popular for saving and retail loan purposes among the people of Kathmandu valley. Now a days, retail banking loan is being considered as one of the most innovative financial services provided by the various banks and financial institutions. This paper presents dimensional analysis of retail loan under interest rate fluctuation in Nepal. Respondents for the study were chosen using convenience sampling and random sampling methods. Convenience sampling was primarily used to select bank employees, while random sampling was used to select bank customers. The structured questionnaire, expert opinion, and pre-test interview are research instruments used in the study to collect data from bank employees and customers of Karhmandu valley. This paper reveals that youth and highly educated people are more attracted towards the retail banking products. Most of the respondents focus that there is a challenge in retail loan.

Contribution/ Originality: This paper contributes as a case study on the ongoing discussion on retail loan under interest rate fluctuation in the developing country. It has discussed customers' interest, challenges and managerial solution for retail loan in case of interest rate fluctuation in the context of Nepal.

1. BACKGROUND

Globally interest rate plays crucial role for banking loan among the customers of all types (Hurley, Morris, & Portelance, 2018). It is the price charged from the borrower for the use of money (Rosenberg, Gonzalez, & Narain, 2009). Interest rate, as the price of money, reflects market information relating to the expected change in the purchasing power of money or the future inflation (Ngugi, 2001). In this context, Su and Chang (2010) emphasize that banks may well set their lending rate according to a certain "mark-up" relative to the deposit rate. Similarly, the role of credit is considered to be the key to economic growth and financial stability of the economy (Timsina, 2017). The rate of interest is really a ratio of interest of two qualities, the money cost of borrowing divided by the amount of money actually borrowed, usually borrowing money measured in rupee per year per rupee borrowed is the interest rate (Berger & Udell, 1995). Likewise, Healey and Dhungana (2013) stated that a high interest rate environment would create sets of winners and losers across the worldwide economy.

While a dramatic increase in the interest rates over the near-term is unlikely, speculation is common that such an increase is not only plausible, but could unfold rather quickly, impacting virtually every major sector of the economy Healey and Dhungana (2013). Thus, Mnang, Namusonge, and Oteki (2016) have analyzed that interest rates are important because they control the flow of money in the economy. From monetary transmission point of view also, the role of banks' loan and advances is crucial because monetary policy operates through banking performance, especially lending (Timsina, 2017). In this circumstance, Fallah (2012) mentioned that a wide deposit-lending rate margin is not only indicative of banking sector inefficiency, it also reflects the level of development of the financial sector. In this regards, Kayode, Obamuyi, Owoputi, and Adeyefa (2015) suggest that loans are a part of the assets of a commercial institution since they are meant to earn interest in the course of time. Hence, Acharya (2018) examined that interest rate can be mitigated, when the borrower requests its lender to fix the interest rate of its loan for the period of the loan.

Nepal's banking system can be characterized by a low turnover volume, a high interest rate on loans, a large interest rate, inefficient management, the lack of project financing practices, the problem of an inadequate work fund and unhealthy competition between banks (Rijal, 2014). Banks in Nepal must remain purely financial institutions and must focus on increasing their profit through banking services and not by real estate speculation. Bhattarai (2016) analyzed most Nepalese commercial banks find themselves approving loans that are not well looked at. This can lead to an increase in defaults and bad debts. Therefore, the existing procedures for managing credit risk are not adequate to compete with the current financial and economic challenges in Nepal. As regards Gross Domestic Product (GDP) growth, credit risk in Nepalese commercial banks fluctuates negatively with GDP growth. By contrast, the interbank interest rate has an insignificant negative impact on credit risk in Nepalese commercial banks (Poudel, 2018). The main problem in the Nepalese industry regarding the provision of the loan is that they do not identify the real need of the customers and offer them the loan to increase their investments and reduce the cost of the inactive fund due to many defaulting loans (Shrestha, 2018). Interest rate drivers on commercial bank loans have often been hotly debated in Nepal. The main concern of the debate is that the price of loans from Nepalese commercial banks has been relatively high for a long time, thus limiting access to capital and inhibiting economic growth. A comparison of loan rate trends shows that a much wider range for loan rate increases is invariably more than for reductions. Although there has been a trend in recent years towards lower loan rates and narrower spreads, they are still relatively high. However, the outcome of reducing loan rates will depend on how banks determine the interest rates applied (Bhattarai, 2017). Credit risk management is now the main task of risk management in banks and credit portfolio management is essential for better credit risk management. The bank's credit transaction determines its management of the credit portfolio (Malla, 2018). Only a few researches have been conducted in the Nepalese context regarding banking interest rate. Therefore, this research is going to identify how the banking loan affects customer behavior mostly in retail product of Nepalese banking sectors. The study may further help suggest the implications required to meet the requirements. The further part of this paper is arranged in the following structure: The literature review occurs in section two. The methodology is discussed in section three. Section four includes the result and discussion followed by the conclusion in fifth section.

2. LITERATURE REVIEW

Regarding the fluctuation of the interest rate loanable funds theory was examined by Bhattarai (2017) that the interest rate is determined by the interaction between demand and supply of borrowed funds. The demand for borrowed funds also includes investments for the production of capital goods and consumer loans. And the offer of borrowed funds includes disposable income, bank money or credit, etc. Similarly, another theory is liquidity preference theory which is discussed by Modigliani (1944). Liquidity preference theory is a model that assumes that investors need to request higher interest rates or premiums for long-term securities with a higher risk. In this sense, since investors do not sacrifice liquidity for longer periods than medium- or long-term securities, the interest rate on short-term securities is lower. Further, the first model is term structure model which is examined by Gibson, Lhabitant, and Talay (2010). The term structure of interest rates is the association between interest rates or bond yields and different terms or maturities.

Similarly, the term structure of interest rates is known as the yield curve and plays a vital role in an economy. The term structure reflects the expectations of market participants regarding future changes in the interest rates and their assessment of monetary policy. Likewise, the arbitrage-free nelson-Siegel model (AFNS model) is observed by Rudebusch (2010). This model combines two traditions of modeling the yield curve. While the theoretical limits of the tradition of similar the arbitrage-free (AF) modeling are maintained, the Nelson-Siegel structure helps to identify the potential factors of the yield curve. As a result, AFNS models can be estimated simply and reliably. Furthermore, the AFNS model shows excellent empirical forecasting performance. The AFNS model provides two applications that show its use in the macro finance studies. In the first application, inflation expectations are better measured by using an estimated AFNS model, which recovers both nominal and actual Treasury prices. In the second application, the effect of the central bank's liquidity line is determined by an estimated six-factor AFNS model of US Treasury yield, Treasury yield, and interbank interest rate.

Sethia (2010) stated that interest rate is the most significant factor in every nation's economy. Interest rate is affected by various kinds of factors, inflation rate and other factors. Further, most organizations do not calculate the true or effective interest rate. They are motivated to achieve profit and it may be different, to some extent, according to the individual bank's policy. So, this team of researchers is motivated to analyze which factors influence the interest rate and which methods are used in calculating the interest rate. Regarding such situation, Dao (2014) argue about the effects of interest rate regulation and deregulation on economic growth and in particular, on the banking system in case of Vietnam that focuses on the influence of deposit ceilings on the banking system. Khan and Sattar (2014) found that interest rate is changed according to the profitability of bank in the context of Pakistan. Singh (2009) observed that many interest rates are equally as unstable as exchange rates and are significantly important sources of risk for companies.

Nepal suffers from a high rate of inflation and is an important factor in the economy. It has a role in determining the interest rate, which is different in different commercial banks. They have their own strategy for determining the rate. The interest rate is a clue to competition in the financial market. The reason for the fluctuation of the interest rate are: the risk of insolvency of the rates, the political crisis, the uncertainty, the demand and the offer, the calculation of the financial market. etc. (Sethia, 2010).

3. METHODOLOGY

This study is conducted in Kathmandu valley. Kathmandu valley (Kathmandu, Bhaktapur, and Lalitpur) is the capital of the country. Being the capital of the country, banks have their head offices (28 commercial banks with headquarters in the valley) located in Kathmandu valley itself. Kathmandu valley is the center for different major industries such as carpets, garments, finance, tourism, health, educational services as well as banking services. In this sense, this study has selected Kathmandu valley because many business activities occur in this city area and there are larger number of retail loan holders than other areas of the nation. The population for this study includes all bank clients of Kathmandu, who work in different sectors and banking staffs as well. In this study our main targeted customers are banking retail loan holders. As covering all the population is difficult task, this study is based on the sample size. Based on Neilson (2011) following formula was used to derive the sample size. i.e., $n = z^2pq/l^2$. Where, n0 = sample size required for study, Standard tabulated value for 5% level of significance (z) = 1.96, p = proportion in the targeted population 50 % = 0.5 (Muyeed, 2012). So, P = 0.5, q = 1-p, = 0.5, with the help of formula we calculate total 384 sample size. The 5% non-response error is appropriate to minimize non-response problem (Adhikari, Gupta, Devkota, Paudel, & Parajuli, 2021), which is 19.21. Thus, sample size required for the study was 403. However, due to several circumstances during data collection, only 383 loan holders are interviewed using various methods of data collection. Hence, this study is based on primary data of 383 loan holders residing in Kathmandu valley. Purposive sampling technique has applied to select respondents for the study. Similarly, data processing and analysis were carried out with the help of descriptive analysis.

4. RESULT AND DISCUSSION

4.1. Socio-demographic Character of the Respondents

Occupancy of retail loan deals with personal characteristics of population expressed statistically such as age, sex, marital status, education level, family type and occupation See Table 1.

Table-1. Socio-demographic status of the respondents.

Variables	Number	Frequency
Gender		
Male	291	75.98%
Female	92	24.02%
Age		
<30	96	25.06%
30-40	153	39.95%
40-50	81	21.15%
50<	53	13.84%
Education Level		
Below +2	12	3.13%
Plus 2	53	13.84%
Bachelor	157	40.99%
Master	123	32.11%
Above Master	38	9.92%
Family Types		
Necular	297	77.55%
Joint	86	22.45%
Occupation		
Business	172	44.91%
Employee	103	26.89%
Agriculture	55	14.36%
Students	40	10.44%
Others	13	3.39%

The utilization of loan for male and female are around 76% and 24% respectively. The male ratio is significantly higher as compared to female in retail banking. In this sense, Ongena and Popov (2016) viewed that due to the higher gender bias, firms owned by females have lower access to bank credit than otherwise similar firms owned by males. Maximum number of respondents was from the age group 30 to 35 i.e., 24.28%. Likewise, minimum number of respondents is from the age group 15 to 20 i.e., 0.52%. It also indicates youth are more attracted towards the retail banking products. Further, the level of education plays an important role in perceiving the bank loan and its interest rate. In this study, awareness is linked with the employee's education levels. It assumes that higher the level of education higher will be awareness level on banking communication. More than 75% respondents are from university education level, which reveals that highly educated ones are more attracted towards the retail banking products. Education shows the level of competency, effectiveness, professionalism, and upgrading of skills in business (Busch & Memmel, 2015).

4.2. Possession of Retail Loan

4.2.1. Sector wise use of loan

Under this study, respondent's occupation was categorized into five categories for carrying out the survey. In the context of retail loan products, the occupations have been categorized as business, employee, agriculture, students, and others. These are the major customers for banking institution. The survey result shows that majority was from business background (44.91%) followed by employees (26.89%), agriculture (14.36%), student (10.44%), and others (3.39%). In this regard, banks have a higher approval rate for small business loans (Mills & McCarthy, 2016).

4.2.2. Account in Financial Institutions and Number of Bank Accounts

Concerning bank account, around 98 percent of the males have accounts in different banks. Likewise, 95.65% females have account. The majority of respondents use private banking sectors to borrow retail banking products. More than two-third percent retail loan holders preferred to borrow loan from the private banking sectors, whereas the rest of the one-third percent respondents are using public banking sector. It is revealed that single customers have accounts in multiple banks as well. Customers with maximum more than three bank accounts (36.03%), with three bank accounts (25.33%), with two bank accounts (23.76%), and only one bank account (14.88%) were also observed in the study.

4.2.3. Financial Institutions and Loan Taken

Regarding financial institutions, most of the respondents have chosen the commercial bank as the source of the loan. Since customers are very sensitive towards the various determinants of the loan, among the tabulate financial institutions, bank score is high in the choice of financial institution for the loan by the customers. In the Nepalese context, commercial banks are gaining a better position with respect to the reputations, financial performance, banking service, product offering, loan processing time as well as the interest rate (Ferrari, Shrestha, & Jaffrin, 2007). Commercial banks have been preferred by most of the respondents (80.38%) for retail loan followed by development banks (14.78%), and only 4.84%respondents have taken retail loan from finance companies. This represents the popularity of commercial banks among retail loan holders.

4.2.4. Purpose of Retail Loan

According to Beck, Demirgüç-Kunt, and Maksimovic (2008), retail loans are those loans which are given by the banks to individuals so as to meet their personal needs and retail loans are smaller in size as compared to corporate loans. There are various types of retail loans which are given by the banks –housing loan, education loan, auto & vehicle loan, personal loan. This study finds that 38% of the respondents received business loan, whereas 48.83% of the respondents obtained auto loan i.e., 21.67% and home loan by 31.59%, education loan by 25.07%, personal loan by 21.15%, and 2.87% of the respondents got loan from their financial institutions.

4.2.5. Motivate to Get Retail Loan from the Banks

58.75% of the respondents are motivated to borrow loan from the innovative product offered by the bank, 54.05% borrowed loan for the betterment of lifestyle. Similarly, 37.08% respondents borrowed loan due to promotion and advertisement campaign and 33.68% respondents were motivated to have loan for the secure of future life. Likewise, 30.55% of the respondents were interested to receive loan if there is lowest interest rate. Lastly, 24.54% were stimulated to get loan to maintain social status.

4.3. Challenges in Retail Loan and process

In this part of analysis, we have discussed about if there is any challenges in retail loan in the Kathmandu valley's financial institutions. Around 84% of the respondents mention there is the challenges in retail loan. In such circumstances, challenges in regulatory requirements on the consumer protection front, risks from a slowing global economy, and increasing customer expectations mean that banks must innovate to grow (Bhattarai, 2017).

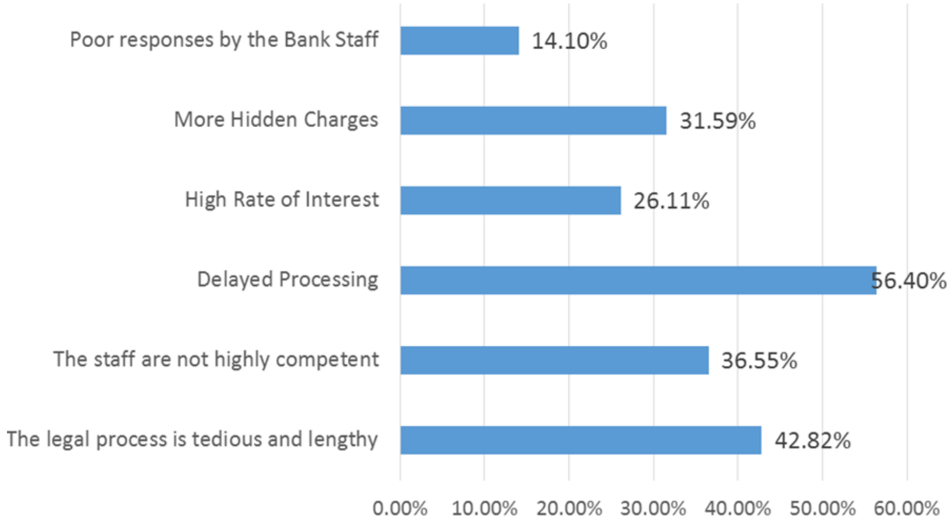

Figure-1. Major challenges in retail loan process.

Concerning loan process,56.40% of the respondent highly agreed on delayed processing, around 42.82% of the respondents viewed on the legal process is tedious and lengthy See Figure 1. Likewise, 36.55% of the respondents stated the staffs are not highly competent. Similarly, 26.11% of the respondents viewed high rate of interest rate and 14.11% of the respondents examined poor responses by the bank staff respectively.

4.4. Managerial Solution

This section explains the customer perception, understanding and best strategy toward overall development of retail banking products. It deals with major attribute i.e., retail loan policy and NRB regulations.

Nepal Rastra Bank Regulation: In every fiscal year, Nepal Rastra Bank imposes interest rate policy to the Nepalese banking institutions. For this situation, we have asked about there was any rules and regulations imposed by NRB related to the loan taken institutions.. More than three-fourth of the respondents found there was policy imposed by Nepal Rastra Bank.

Regulations and Policies Implementation Intensity: In this part of interview, we had asked our respondents about how the regulations and policies have significant influence in implementation. The intensity of the regulations and policies implementation was measured in the scale of 1 to 5 with 1 indicating very low, 2 low, 3 moderate, 4 high and 5 indicating very high (See Figure 2). The majority of respondents felt moderate regulation and policies implementation. For such argument, Clark and Jokung (2015) have asserted that when regulatory intervention is perfect and costless, the volatility of the bank system can be substantially reduced with no loss of productivity.

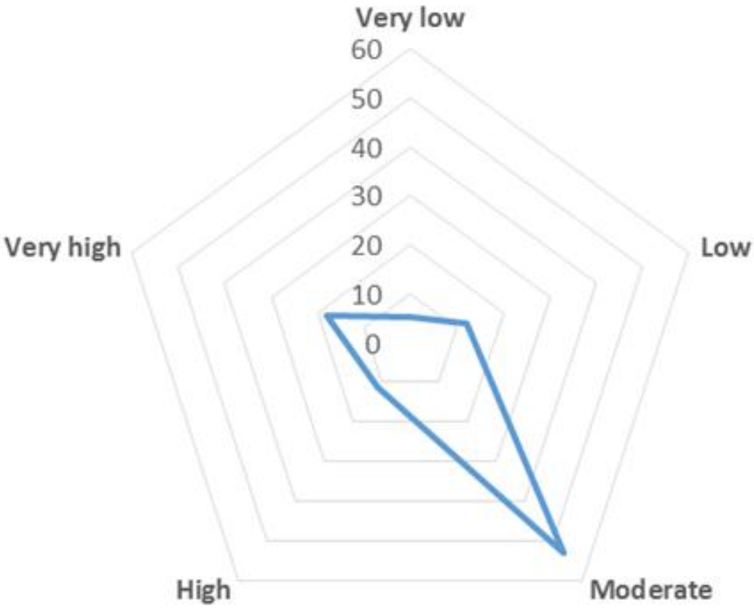

Figure-2. Intensity related to Regulations and Policies Implementation.

5. CONCLUSION

This paper aims to explore dimensional analysis of retail loan under interest rate fluctuation in Nepal. Retail loan is an important determinant of the investment decision of firms and households in Nepal. Interest rates are key indicators of the short-term funding for small business firms. In Nepal, banking system can be characterized by a low turnover volume, a high interest rate on retail loans. The study discloses the male ratio is significantly higher as compared to female in retail banking. Similarly, youth and highly educated people are more attracted towards the retail banking products. Around four-fifth percent of respondents argue that there is a competitive interest rate, whereas small percent of respondent found that there is not a competitive interest rate. However, more than 50% of respondents found there is stable interest rate, whereas 40% found not. Similarly, more than two-third of the respondents viewed there is no any panel interest charge, whereas one-third of the respondent fount not. For the most of the respondent's reference there is challenges in retail loan, whereas about few of them respondents deny.

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