

Analysis of Factors That Affect Group Loan Repayment Performance of Microfinance Institutions in Orumba South Local Government Area of Anambra State

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Abstract

Microfinance institutions (MFIs) primarily exist to offer small enterprises and poor household access to credit facilities as well as other financial products and services. MFIs in Nigeria adopt group based lending method as a strategy to encourage borrowers' compliance with repayment obligations. Despite this strategy, repayment problem still persists in MFIs. The aim of this study is to determine those factors that affect group loan repayment performance of MFIs in Orumba South Local Government Area of Anambra State. Two research questions and two hypothesis guided the study. Five microfinance banks that engage in group lending and 53 self-help groups were studied. The study applied purposive sampling technique to select 61 respondents from MFIs and self-help groups. Sixteen-item questionnaire was used to elicit responses from the respondents. Mean and standard deviation were used to analyse the data collected, while Chi-square was used to test the two hypothesis. The result showed that there exist significant relationship between group's loan repayment performance and lender-related factors, among others. The study recommended, among others, that MFIs' management should pay more attention to those factors identified that affect loan repayment performance.

Keywords: Loan, Microfinance Bank, Orumba South,

Introduction

There is a current world wide belief that microfinance is one of the powerful development tools with which to eradicate poverty through the provision of timely, affordable and dependable financial services to the economically active poor and low income household. Throughout history, credit has been a key factor for the creation of wealth since loans to small businesses and individual entrepreneurs foster self-reliance and community-wide economic development, (Hadiza, 2005). Governments the world over have always been confronted with the challenges of empowering the poor with the view of enabling them play their role in economic development.

Usually the poor survive through involvement in micro business activities or informal activities that comprise food processing and sales, small scale agriculture, services, crafts and petty trading. These activities actually contribute to total employment and Gross Domestic Product (GDP) of a country. In fact, micro and small enterprises have been recognized as a major source of employment and income in many countries of the Third World. Nawai and Shariff (2010) posit that micro enterprises provide income and employment for significant workers in the rural and urban areas by producing basic goods and services such as traditional foods, craft, barbing and hair salon and hawkers for the needs of rapidly growing populations. Izundu (2014) reported that micro enterprise make a major contribution to aggregate employment, production and national income in developing economies.

Micro entrepreneurs can only be empowered by increasing their access to factors of production especially credit. Lack of access to credit or fund is a major factor that created poverty as the latent capacity of the poor entrepreneurship would only be enhanced through the provision of necessary funds. Funding of micro enterprises would ensure flow of funds to rural poor who have ideas of what to do to earn a decent living but are hindered by lack of money. Unfortunately the poor are usually excluded from credit facilities because of many reasons. These reasons include inefficient collateral to support their loans, high transaction costs, unstable income, lower literacy and high monitoring costs, (Shariff and Nawai, 2010). In Nigeria, for instance, the formal financial system provides services to about 35% of the economically active population while the remaining 65% are excluded from access to financial services, (CBN, 2010). In order to fill this gap, microfinance institutions are set up to provide microfinance to micro enterprises.

Microfinance Institutions (MFIs) are finance institutions with a special mandate to assisting small enterprises and poor household that generally have no access to the more formal financial institution (Hadiza, 2015). These institutions exist primarily to meet the unsatisfied demand created by the inability or unwillingness (or both) of more formal financial institutions. They offer to small enterprises and poor household access to credit facilities as well as other financial products and services. The major function of MFIs is the provision of micro credits to microenterprises because of its direct effect on economic growth and development. The concept of micro lending was pioneered in Bangladesha by Mohammad Yunus to assist low-income women and men through micro enterprises for their economic development (Nawai and Shariff, 2010).

The repayment of any loan extended by MFIs is of paramount importance to these institutions. The expectation of every lender is that the customer to whom the credit is extended will repay both the principal and interest as agreed. MFIs are quite dependent on loan repayment to get funds for future loans. The sustainability and viability of MFIs is important to make sure that MFIs can continually provide financing to micro enterprises.

MFIs essentially extend loans to their clients without physical collaterals because poor household cannot offer collaterals to back up their loans. Being aware of this peril, MFIs schemes have usually incorporated a number of safeguards, the most prominent of which is group lending. In group-based lending, borrowers must form a group before applying for loans. The whole group is liable if one or more members default. Thus joint liability provides an insurance against individual risks. Even if an individual project fails and some of the borrowers are unable to repay, the group as a whole might still be able to do so. In this sense joint liability serves as a substitute for collateral. Therefore, MFIs are often referred to as Joint Liability Lending Institutions,(Abbink, Irlenbusch and Renner, 2002). The expectation is that group lending approach will eliminate or mitigate the problems of loan defaults in MFIs.

Concept of Group Lending

A group lending is a lending mechanism which allows a group of individuals, often called a solidarity group to provide collateral or loan guarantee through a group repayment pledge. The incentive to repay the loan is based on peer pressure; if one group member defaults the other group members make up the payment amount (Ralph, 2011). It is a form of collateral substitute in which borrowers form groups all of whose members must maintain a satisfactory payment record for any group member to be eligible for future loans.

In group-based lending, borrowers must form a group before applying for loans. The whole group is liable if one or more members default. Thus joint liability provides an insurance against individual risks. Even if an individual project fails and some of the borrowers are unable to repay, the group as a whole might still be able to do so. In this sense joint liability serves as a substitute for collateral. Microfinance institutions are therefore often referred to as Joint Liability Lending Institution, (Abbink, Irlenbusch and Renner, 2002). Thou and Juma (2014) described group lending as a veritable strategy in micro credit. It helps to screen out risky borrowers and create peer pressure to monitor and enforce the terms of the loan. The scheme makes members jointly liable for the repayment of loans

and gives subsequent credit only if all members of the group have fully repaid. The threat of losing access to future credit incites members to perform various functions, including screening of loan applicants, monitoring the individual borrowers' efforts, fortunes and shocks and enforcing repayment of their peers' loans (Guta, Desta and Ferede, 2014).

Joint liability leads to an enhanced repayment performance through lessening the four major problems facing formal credit institutions in lending to the poor. The problems are: (a) to ascertain what kind of a risk the potential borrower is, (b) to make sure they will utilize the loan once made, properly, so that they will be able to repay it, (c) to find out how their project really did in case they declares their inability to repay and (d) to find methods to force the borrower to repay the loan if he is reluctant to do so (Nawai and Shariff, 2010).

Problem of the Study

For microfinance institutions to continue to provide financial services to the poor on a sustaining basis, they must be viable and sustainable. MFIs are quite dependent on the loan repayments to get funds for future loans. The chance that a MFI may not receive its money back from borrowers (Plus interest) is the common and often the most serious vulnerability in MFI, considering the fact that these microcredits are not secured. MFIs, adopt group-based lending method to mitigate this problem. The emergence of innovative group lending model in the field of microfinance is celebrated as an innovation that has encouraged compliance with repayment obligations, (Thou and Juma, 2014).

In Nigeria, MFIs have shifted emphasis to group lending approach in extending credit to low income groups. Nevertheless the expectation that the approach will eliminate or mitigate the problem of loan default has not been materialized and to date a large number of MFIs in Nigeria are confronted by the challenges of rising non-performing loan portfolio. The Central Bank of Nigeria Banking Supervision Report (2016) indicated high incidence of credit risk reflected in the rising levels of non-performing loans by the MFIs in the last ten years, a situation that has adversely impacted on their profitability. The above scenario raises the question on the effectiveness of group lending approach in mitigating loan defaults in MFIs.

Objective of the Study

The major purpose of the study is to examine the factors that influence successful group loan repayment performance of MFIs with

particular reference to Orumba South LGA of Anambra State. Specifically, the study will achieve the following objectives:

1. To determine the group borrowers-related factors that contribute to loan repayment performance of MFIs
2. To determine the lender's-related factors that affect loan repayment performance.

Statement of Hypothesis

The following hypotheses were formulate and tested at 0.05 level of significance. The hypotheses are stated in the null.

1. There is no significant relationship between group borrowers-related factors and loan repayment performance of MFIs.
2. There is no significant relationship between lender-related factors and loan repayment performance of group borrowers.

Method

The research employed a survey research design. The study was carried out in Orumba South Local Government Area of Anambra State. Group borrowers and microfinance Banks that engage in group lending in Orumba South Local Government Areas were studied.

The study population comprises 51 registered group borrowers and 5 microfinance banks that engage in group lending. The study applied purposive sampling technique to select only loan officers of the 5 microfinance banks and group leader of each group borrowers. Group leaders are selected because they look after members of their group and are assumed to know the required information. Thus a total of 10 loan officers of MFBs and 51 group leaders were selected, giving the sample size of 61 for the study.

The instrument for data collection for the study was a 16-item structured, pretested questionnaire. The ordinal scale questionnaire consisted of 5-point scale with responses of Strongly Agreed (5 points), Agreed (4 points), Undecided (3points), Disagreed (2points) and Strongly Disagreed (1 point). The questionnaire was validated by two experts in the field of Finance. The research employed a test-retest method to establish the reliability of the instrument, using the Pearson Product Moment Correlation Coefficient. The correlation coefficient of 0.86 obtained was considered high enough measure of reliability of the instrument. The instrument was administered personally by the researcher on the target population through a face-to-face method. This method made it possible to achieve total return of 53 which is eighty six percent response rate.

Data collected were analysed using mean and standard deviation. The two hypotheses formulated were tested using Chi Square at 5 percent level of significance. A mean score of 3.50 and above were considered effective while items with mean score below 3.50 were not effective.

Data Presentation and Result

Table 1: Mean Responses on Borrower-Related Factors that Influence Loan repayment Performance.

S/N	Item	Mean	SD	Decision
1.	Group’s operating rules (Internal constitution).	4.57	.54	Effective
2.	Democracy practice in group governance.	4.17	.64	Effective
3.	Age of the business engaged by the borrower.	3.98	.66	Effective
4.	Diversion of fund to another use other than the purpose it is intended.	4.15	.63	Effective
5.	Borrowers changing frequently their areas of residence (Tenancy problem).	4.25	.68	Effective
6.	Self-selection of members by the group without intervention of another body.	4.47	.50	Effective
7.	Pre and Post loan training for group members by MFIs.	4.25	.55	Effective
8.	Suitability of the repayment period.	3.84	.89	Effective

Table 1 above displays the mean responses of loan officers and group leaders on group specific factors that affect loan repayment. Mean values of all the items ranged from 3.84 to 4.57. These mean values show that respondents strongly perceived these factors as affecting groups loan repayment. Specifically the greatest strength in these factors is groups internal constitution (4.57).

Table 2: Mean Responses on Lender-Related Factors that Affect Loan Repayment Performance.

S/N	Item	Mean	SD	Decision
1.	Management information system of the MFIs	4.36	.65	Effective
2.	Constant loan supervision by loan officers	4.15	.63	Effective
3.	Constant training of loan officers	4.02	.64	Effective
4.	Use of local authorities in loan recovery.	3.79	.53	Effective

5.	Giving loan demand notice to borrower clients by lending MFIs	3.65	.68	Effective
6.	Experience of credit officers	4.13	.59	Effective
7.	Outreach (i.e. the number of people covered by MFIs)	3.85	.89	Effective
8.	Encourage group members to coax colleagues to repay their debts.	4.19	.59	Effective

Table 2 above shows that all the 8 items presented were strongly considered by respondents as MFIs-related factors that influence loan repayment performance. These items have mean range of 3.65 to 4.36.

Testing the Hypothesis

The two hypotheses formulated in the study were tested using Chi-square test at 5 percent level of significant at 4 degree of freedom (df). The formular for Chi-square is given by

$$X^2 = \sum \frac{(f_o - f_e)^2}{f_e}$$

Where x^2 = Chi-square

F_o = Observed frequency

F_e = Expected frequency

Σ = Sum of

The degree of freedom (df) is given by (n-1) where n is the number of categorizes. The number of categories of response in this study is 5.

Therefore $df = (5-1) = 4$.

The expected frequency (fe) is $53/5 = 11$

Management information system variable was used as a proxy for lender-related factors, while groups operating rules was used for borrower specific factors. The variables were selected on the bases of their mean. The decision rule is: reject null hypothesis if calculated value of $x^2 >$ the critical value and accept alternative hypothesis.

Hypothesis One

Ho: There is no significant relationship between group borrowers-related factors and loan repayment performance of MFIs.

Table 3: Respondents view on Group Borrowers Specific Factors

Options	SA	A	UD	D	SD
Observed (Fo)	38	10	3	1	1
Expected (fe)	11	11	11	11	11

Table 4: X² Comparism of the Relationship between Group Borrowers specific factors and Loan Repayment Performance.

Responses	Fo	Fe	Fo-Fe	(Fo-Fe) ²	$\frac{\Sigma(\text{Fo-Fe})^2}{\text{Fe}}$
SA	38	11	27	729	66.27
A	10	11	1	1	0.09
UD	3	11	-8	64	5.82
D	1	11	-10	100	9.09
SD	1	11	-10	100	9.09
					90.36

From the above table, the calculated value of χ^2 is 90.36. The table value is 9.49 (5% level of significance at 4df). Since the χ^2 calculated is greater than the table value, we reject the null hypothesis and accept the alternative which posits that there is significant relationship between group borrowers-related factors and loan repayment performance.

Hypothesis Two

Ho: There is no significant relationship between lender specific factors and loan repayment performance of MFIs.

Table 5: Respondents view on Microfinance institutions specific factors.

Options	SA	A	UD	D	SD
Observed (Fo)	30	15	4	2	2
Expected (fe)	11	11	11	11	11

Table 6: X² Comparism of the Relationship between Lender-Related Factors and Loan Repayment Performance

Responses	Fo	Fe	Fo-Fe	(Fo-Fe) ²	$\frac{\Sigma(\text{Fo-Fe})^2}{\text{Fe}}$
SA	30	11	19	361	32.82
A	15	11	4	16	1.45
UD	4	11	-7	49	4.45
D	2	11	-9	81	7.36
SD	2	11	-9	81	7.36
					53.44

Table 6 above shows that the calculated value of χ^2 is 53.44. The table value of χ^2 is 9.49. Since χ^2 -cal is greater than the critical value; null hypothesis is rejected while the alternative hypothesis is accepted. This means that there is significant relationship between microfinance institutions specific factors and loan repayments performance of MFIs.

Discussions

The study was carried out to determine those factors that significantly affect loan repayment performance of MFIs in relation to group borrowers. In this regard the study examined the effects of MFIs -related factors and borrowers-related factors on loan repayment performance of MFIs.

In relation to MFIs -related factors, the study revealed those variables which are within the direct control of MFIs that affect loan repayment performance. These factors included management information system, constant loan supervision by loan officers, regular training of loan officers, and use of local authorities in loan recovery process. Other factors identified are loan demand notice to borrower clients, experience of credit officers, outreach of the MFIs, and Peer pressure. These variables influence loan repayment either positively or negatively depending how they are managed.

Chi-square result revealed that there is significant relationship between loan repayment performance and lender-related factors. This suggests that loan repayment performance is dependent on quality management on these factors which are within the direct control of the MFIs management. These results concur with Adekunle (2016) findings that inefficient management of internal factors in MFIs contributes to loan delinquency performance in MFIs. In addition, the findings agree with the work of Ezenaya (2015) who also observed that erosion of MFIs lending discipline contributes to increased defaults.

In relation to borrower-related factors, the Chi-square test revealed a significant relationship between the groups-related factors and loan repayment performance. This suggests that loan repayment performance is dependent on those factors that are considered to be within the direct control of the group-borrowers management. The result showed these group specific factors as internal constitution guiding the group, democratic governance, age of the business of the borrower, self-selection of group members, Pre and Post loan training borrowers, and diversion of borrowed funds to another use other than the initial purpose. Other factors revealed include frequent change of area of residence by the borrowers, and

suitability of the repayment period. These findings concur with the work of Umoh (2015) who observed that loan repayment performance is dependent on borrower using the borrowed funds for the purpose intended for and avoidance of diversion of funds to unplanned activities. This, according to him, may enhance steady cash flow from the invested funds for loan repayment; hence decrease in loan delinquency levels. Warue (2012) discovered in his study that tenancy problem has negative and significant effect on loan repayment performance. When borrowers change their area of residence frequently, it becomes difficult for loan officers to follow up loan repayment. Also Ugbogu (2017) found out that the group formation process which includes selection of new members of the group by the group itself based on the character and behaviour of members will enhance group solidarity and thus reduce loan delinquency levels.

Conclusion

The study examined microfinance institutions and group-borrowers specific factors to determine if these factors significantly affect loan repayment performance in Microfinance Institutions in Orumba South Local Government Area in Anambra State. The study established significant relationship between lender/borrower specific factors and loan repayment performance. Both lender specific factors and borrower specific factors jointly affect loan performance of MFIs in Orumba South Local Government Area.

From the findings of the studies, it follows that the loan repayment performance of MFIs depends on the MFIs and self help groups to efficiently manage specific factors which are considered to be within the direct control of their management. Therefore for effective management of loan repayment, it is critical for MFIs to understand and focus more on these factors which they have more control over.

Recommendations

Based on the findings of the study, the following recommendations were made:

1. MFIs management should regularly review their credit operation techniques for effective credit portfolio assessment.
2. Further more, self-help groups management should strengthen group solidarity to facilitate group loan repayment by the group members.
3. Regulatory agencies should create awareness among group borrowers on why the borrowed loans should be repaid. They should

be meant to understand that MFIs can only have sustainable and viable operations if borrowed funds are repaid.

4. Management of MFIs should lay more emphasis on self initiated groups when screening group borrowers. This is because self initiated groups are more homogeneous with strong social ties.
5. In addition, MFIs should set a suitable loan repayment period for borrowers, taking into consideration the nature of business of the borrower.

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