



Microfinance Banks' Lending Rate and Repayment Capability of Borrowers in Some Selected Microfinance Banks' in Kaduna State, Nigeria

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Abstract

The research investigated the lending rate and repayment capability of microfinance banks' (MFBs) borrowers in Kaduna State, Nigeria with case study of some selected MFBs having a population of fifty three from where twenty MFBs were selected for this research. The study is purposive (or judgemental) research design. The cox regression was used for the analysis of data obtained from primary source through the use of questionnaire. It was found out that there is positive significant relationship between lending rate and repayment capability of borrowers with hazard ratio of 1.0000 and 1.00019 at 0.01%. It was suggested that there should be consideration for re-negotiation of loan term and condition to improve repayment capability of the borrowers to avoid outright loss of loan and interest.

Keywords: lending rate, repayment capability, repayment pattern, repayment instalment, repayment period.

INTRODUCTION

In early 1900s, the informal financial institutions like esusu (Yoruba), adashi (Hausa) were paramount as the rotating savings and credit association in Nigeria. In 1936, the cooperative society decree was propagated by the Nigerian Government. Among other things, the main goal of cooperative societies is savings mobilization, while thrift and credit societies combine savings mobilization with credit administration. A large number of cooperative societies were established in the Eastern part of the nation based on prevailing isusu (Igbo) in 1940s which had advanced from rotating to non- rotating association with permanent loan funds while majority of the informal financial institutions had transmuted into listed cooperatives by 1950s. There are several rural financing scheme arrangements such as, people's bank, money lenders, and so on

before the advent of community banks in 1990 mainly meant for non-sophisticated loan to the communities (CBN, 2005)

The existing community banks were authorised by the apex bank to convert to microfinance banks (MFBs) in 2005 with a new capital base of N20 million and a target for compliance by December, 2007. The initiation of microfinance banks' policy is to make financial services accessible to the over eighty million Nigerians underserved by official financial institutions, especially those who are economic active low-income earners and little income families/households who could not have contact to services provided by the commercial banks/deposit money banks (formal financial institutions) (Lemo, 2006).

The main aim of setting up microfinance banks in Nigeria according to the Microfinance Policy, Regulatory and Supervisory Framework of 2005 revised in 2011 by the Central Bank of Nigeria was to reach the majority of the economically active poor, generate jobs, alleviate poverty and ensure that the percentage of the total credits in form of microcredits increase in the economy from 0.9 per cent in 2005 to 20 per cent by 2020 while microcredit to GDP increased from 0.2 per cent in 2005 to at least 15 per cent in 2020 to promote government participation in micro-financing through state and local government micro-credit financing by 2015, improve women's access to financial services by 5 per cent annually (CBN-MPRSF, 2005).

Loan repayment has been a serious difficulty of formal financial institutions in Nigeria most particularly the microfinance banks (Babajide, Taiwo & Isibor, 2015). The survival of microfinance banks hinges largely on their skill to collect loans given out as proficiently and successfully as possible. To be financially worthwhile or maintainable, microfinance banks must safeguard high portfolio excellence based on 100% repayment, or at worst low default, cost of recovery and resourceful lending. When a loan is not performing, it contradicts the profitability of microfinance banks which unfavourably affects their financial performance which may make potential borrowers not to have access to credit facilities since part of the funds that could have been extended as loan by microfinance banks have been tied to default. Coker & Audu (2015) described 54% repayment rate from total loan granted to the farmers, likewise Onoja & Emodi (2012) recounted a repayment rate of 59%. Obamuyi in (2011) reported 34.06% repayment rate by micro-credit institutions in Ondo State. Njoku & Odii (1991) documented 27% repayment rate among farmers in Imo State while in another study by Njoku & Obasi (1991) had 33.72% as repayment rate in their study in Imo State which showed that the microfinance banks repayment patterns have challenges which warrant critical solution so that the industry does not flop.

Poor repayment rate of credit lessens lenders' net return thus decreasing the capability of the institution to make resources internally for institutional growth. Okpugie (2009) identified great lending rate on credits by microfinance banks as a cause of outrageous loan default equally unregulated interest rate which is 30% on a moderately short term and reducing balance rate while 60% on flat rate contribute profoundly to defaults by clients of microfinance banks in Nigeria.

Despite all the arrangements put in place to ensure sustainability of microfinance banks in Nigeria, high failure rate among microfinance banks call for concern. Several studies like (Nwanyanwu, 2011 and Acha, 2012) have traced failure of microfinance banks to poor practice and inefficient delivery of microcredit while some traced failure among microfinance banks to low technical capacity and unskilled personnel but not many studies have looked into issues around credit administration and management. This study therefore filled the gap in literature on the impact of lending rate on repayment capability of microfinance banks' borrowers. The main research question set for this study is; how does lending rate affect

repayment capability of micro borrowers in Nigeria? The rest of the paper is divided into four sections-literature review, methodology, findings and discussion of results, and concluding remarks and recommendations.

Research Question

How does lending rate affect repayment capability of customers in microfinance banks?

LITERATURE REVIEW

There are many theories on firm survival and financing, for example pecking order theory is one of them that postulates that the cost of financing increases with asymmetric information, it is a theory that relates to the capital structure of a firm initially suggested by Donaldson, modified and popularised by Myers and Majluf. According to this theory, a hierarchy is followed by managers to choose sources of finance which gives first preference to internal financing while others are debt and equity.

There had not been any official record on when the implementation of microfinance in Nigeria started but has been naturally dated back to some spans over 100 year in the informal sector of the economy, while formal delivery of microfinance in its present nomenclature is dated back to 2005, with the delivery of access to credits for the rural and urban, low-income earners (Onoyere, 2014).

Non-performing loans in microfinance banks had considerably added to the financial grief in the sector as witnessed in the past five years where non-performing loans led to the liquidation of one hundred and sixty-two microfinance banks in Nigeria in 2013 (CBN, 2013). Also, the weak capital base of prevailing microfinance banks could not sufficiently provide cushion for the risk of lending to microfinance banks' clients. The dread of depositing monies in microfinance banks becomes a challenge; microfinance banks' clients became nervous of banks becoming insolvent due to the low paid-up capital, lending activities became precautionary and discriminatory with a provision for collateral (Adu, 2013). Also in some cases when credit facilities are approved for clients, the repayment period for both the loan size and interests becomes a court case. The causes presumed for this is that the interest rate ranges from 30 to 60 per cent and above on a flat rate while loan repayment period is usually short; three (3) six (6) months posturing repayment encounters to existing and prospective borrowers, likewise increasing bad debts which become massive and institutes an intimidation to the sub-sector (Arizona,2008)

The repayment platform called Nigeria Deposit Insurance Corporation for depositors of microfinance banks, and other banks that have been declared bankrupt or liquidated or shut as a result of maladministration or had their licenses withdrawn is supplemented by the action of Central Bank of Nigeria to sanitise the sector which has brought some relief, steadiness, and have improved investors' assurance on the sector.

The Central Bank of Nigeria's microfinance policy was introduced for every operator in the sub-sector to be strictly sound, suitably capitalized, and focused on the lending principles based on the regular cash flow and character of clients.

The apex bank (Central Bank of Nigeria) as part of her regulatory strategy has grouped microfinance banks into three (Babajide, Taiwo & Isibor, 2015) which are "unit microfinance banks" approved to run in one location in a local government area but banned from having branches and cash centres in other locations of the state, local government and villages starting with a capital base of N200 million (two hundred million naira); the "state microfinance bank" as the second group is mandated to operate in a state or the Federal Capital Territory (FCT) having official permission to open branches within the same state or Abuja (the FCT) based on

preceding written approval by the apex bank for each new branch having a minimum capital base of N1 billion (one billion naira) while the “national microfinance bank” is the last group accredited to function in more than one state including Abuja, equally allowed to open branches in all states of the Federation and the Federal Capital Territory Abuja subject to the preceding consent by the Central Bank of Nigeria, and a mandatory capital base of ₦5 billion (five billion naira) (MSRP, 2005/2011)

Repayment Frequency as a Device

Microcredit or microloan repayments are scheduled on daily, weekly, or monthly whose repayments start as soon as the loan pay-out is made likewise the instalment size or instalment amount for each repayment is stable and cannot be renegotiated throughout the period of loan repayment. It had been advocated that inflexible or stiff repayment schedule or pattern by many microfinance professionals has helped borrowers to be financially disciplined (Adu, 2013).

Some empirical evidences revealed that borrowers do encounter complications in their savings which are unpredictable because of the poor or low income (Ashraf et al. 2006; Gugerty 2007; Collins et al. 2009) which may have to do with the lines of behavioural flaw and present preferences. The severe loan repayment pattern having frequent repayments gives borrowers the prospects to improve savings habit while an intending borrower that wishes not to default will need rigid repayment pattern to support his loan (Laibson, 1997).

It was revealed in a study conducted by Bauer et al. (2012) in India on relationship between behavioural weakness and microfinance involvement that a stiff repayment pattern with frequent repayments should be used to buttress borrower’s commitment. The regular repayment in practice has virtually the same meaning as frequent saving and can also expand the welfare of biased borrowers by enabling optimal consumption allocation is a commitment scheme used as a rule by microfinance banks (Fischer & Ghatak, 2010).

There was no significant variance in the repayment rates between equating the weekly repayment group borrowers and monthly repayment group borrowers by Field & Pande (2008) but in the future, the weekly repayment pattern may not be crucial in providing a functioning commitment device and it was specified in the results that it may be promising to decrease the expenses connected to weekly gatherings, for both the microfinance banks and the borrowers by approving a more infrequent repayment pattern without worsening repayment performance.

A severe problem for a rigid repayment pattern is often perceived as periodic variations in income of the rural areas that also cause seasonal variations in consumption (Khandker, 2012) by which a borrower typically faces income uncertainty at times; income fluctuation is a prevalent occurrence that makes smooth consumption hard over time whether it happens certainly or randomly. The hitches connected to the incompatibility between the loan repayment pattern and borrowers’ cash flows have been lessened lately by the introduction of some repayment rules by microfinance banks.

During the period of natural catastrophe in Bangladesh, borrowers were given permission to reorganize their loan repayments which meaningfully decreased their dependence on the informal money-lenders and empowered consumption (Shoji, 2010) likewise borrowers who faced repayment challenges as a result of drought, flooding in Thailand by the Bank for Agriculture and Agricultural Cooperation were allowed loan renegotiation (CGAP/IFAD 2006). A flexible repayment schedule will invite more clients who are facing income doubt but are afraid of a likely default when they come across negative surprises loan repayments can be safely rescheduled if the shocks are readily witnessed by the lenders.

Clients generate high income which is assumed to be an account of assurance to savings after harvest period while deduction should be permissible only during period of natural disaster, such as in emergency seasons which will help the underprivileged with biased preferences to alleviate seasonal disparities in income to some magnitude. Confianza in Peru and Banco Los Andes Pro Credit in Bolivia experimented the low-income season allowable for deferment of repayment which depicted that loan products repayments should be set according to revenue flows (CGAP/IFAD 2006).

Deferment of repayment heightens the duration of business development over a long term by allowing a larger investment during the preliminary periods and a grace period of two months before repayments start should be allowed before the investment selection of business enterprises, and grace periods cause a change in investment returns, and high default rates (Field et al., 2011)

METHODS AND DATA

Survey research method was adopted for this study. The success of loan repayment is tied to three objectives: loan size, repayment pattern and lending rate. In total, two hundred copies of questionnaire were administered to microfinance banks' clients in Kaduna State of Nigeria as respondents while one hundred and eighty two were returned. Data were collected within the duration of one month due to distance.

A well-structured multi-item questionnaire was designed to obtain information from the respondents. In the questionnaire, clients who were on loan repayment period were the ones given questionnaire to fill. The section A of the questionnaire comprised of the bio- data of each respondent while section B comprised of three constructs on repayment capability, loan size and lending rate. A five-point Likert scale measurement was used which were Agreed, Strongly Agreed, Indifferent, Disagreed and Strongly Disagreed.

Method of Data Presentation and Analysis

In this study, both descriptive and inferential statistics were used. One hypothesis was formulated and analysed using cox regression. This is done to test the effect of lending rate on the repayment capability of microfinance banks' customers in Kaduna State of Nigeria.

MODEL SPECIFICATION

The model below was adapted from the work of Onyeagoacha, Chidebelu, & Okorji in 2012 and slightly modified to suit this study to capture all the measurable variables as indicated below

Model I

$$RPC = f(LOS, LR, RPP) \dots \dots \dots (1)$$

Equation could be explicitly expressed as

$$RPC = \beta_0 + \beta_1LOS + \beta_2LR + \beta_3RPP + \epsilon_t \dots \dots \dots (2)$$

Where;

- RPC is Repayment Capability
- LOS is Loan Size
- LR is Lending Rate of microfinance banks
- RPP is Repayment Pattern
- β_0 is the intercept
- $\beta_1 \dots \beta_3$ are the slope coefficients

MEASUREMENT OF VARIABLES

As mentioned earlier, data for the study were collected using survey research design. Variables were drawn from the literature and data were collected to represent each variable. For each of

the variables, set of questions were formulated, transcribed, weighted and averaged to form composite indices for each construct.

RESULT PRESENTATION AND DISCUSSION

This chapter presents the detailed description of the results of the data analyses from the primary. The results obtained from frequency distribution and percentages. The descriptive statistics are presented in tables and graphs while empirical results were estimated based on models in 3.0

Table 4.1: Descriptive Analysis (Primary data)

Descriptive Analysis		
Gender	Frequency	Per cent
Male	58	31.9
Female	124	68.1
Total	182	100.0
Age	Frequency	Per cent
20-30 years	48	26.4
31-40 years	109	60.0
41-50 years	23	12.6
51 years and above	2	1.0
Total	182	100.0
Educational Qualification	Frequency	Per cent
Primary School Certificate	53	29.1
WACE/GCE/NECO	76	43.0
HSC/NCE/OND	23	12.6
HND/B.Sc.	26	14.3
M.Sc./PhD.	4	1.0
Total	182	100.0
Occupation	Frequency	Per cent
Trader	41	22.5
Farmer	37	20.3
Artisan	55	30.2
SME owner	23	12.6
Teacher	14	7.6
Civil servant	11	6.0
Others	1	0.5
Total	182	100.0

Source: Researcher's Survey, 2018

The demographic information of the respondents in the table above indicates the sample size of the survey study consists of 58(31.9%) male and 124(68.1%) females suggesting that the female clients constitute greater proportion of the study.

This additionally buttressed the fact that microfinance banks target female clients, the confirmation of more female beneficiaries of microfinance bank's loan is a confirmation in Onoja & Emodi (2012), Grameen Bank quoted in (Julius and Azeez,2011) which held that advancing micro-credit to women would enrich better loan repayment than when advanced to men which substantiated the affirmation of Armendariz & Morduch (2005) that most of the studies which advanced hypothetical opinions about female steering in loan were not supported by practical substantiation except in this study where it is empirically established that more female microfinance banks' customers enjoyed loan facilities than the male customers.

The age distribution of the participants shows 48(26.4%) of the sample within the age bracket of 20-30 years, 109(60.0%) which constitutes the largest portion of the respondents were within the age limit of 31-40 years, 23(12.6%) fall within the age bracket of 41-50 years while 2(1.0), the last category of the respondents were 51 years and above. This implies that the more economically active population are prone to borrowing from microfinance banks in a bid to acquire more economic power and financial independence. Eze & Ibekwe (2007) deep-rooted the above indication in their study on determinants of loan repayment in Imo State where loan size, age of beneficiaries, household size, number of years of formal education and occupation were identified as the key forecasters of loan repayment which is in line with this research that the economically active age of the customers is one of the criteria considered for loan by some microfinance banks in Kaduna State of Nigeria.

From the descriptive table above, 53(29.1%) had their primary school certificate, most of the participants 76 (43.0%) were WAEC/GCE/NECO holders, followed by those 23 (12.6%) who were HSC/NCE/OND holders, 26 (14.3%) were either HND or B.Sc. graduates while 4(1.0%) fall within the M.Sc. and PhD categories. This indicates that majority of the borrowers consists of entrepreneurs with low level education.

Onyeagocha, Chidebelu & Okorji (2012) originated that there was reduction in default rate with loan size, educational level, occupational length of experience, the supported ability of the business in making profits plus diversity of portfolio, and multiple enterprises ownership which have shown that ceaseless failure of small businesses is as a result of the people's educational level in managing the business while many of the businesses do not grow because of the manager's low educational level. The occupational demographic distribution of the respondents show these beneficiaries of the microfinance banks' loan which were traders 41(22.5%), teachers 14(7.6%), civil servants 11(6.0%), artisans 55(30.2%), farmers 37(20.3%), small and medium enterprise (SME) owners 23(12.6%) and others 1(0.5%). This could be explained by the reason that generally in most cases, loans obtainable from microfinance banks run between 6 months and 1 year which are usually working capital. Highest loan in a microfinance bank is 24 months except in some extraordinary cases like housing loan. Though in some cases farmers that plant cash crops and perennial crops with long gestation periods of 2 to 3 years may be given longer periods pending the period of harvest and sales before repayment of loans can start.

Table for Cox Regression Estimates for Repayment Capability

Variable	Haz.Ratio	Std. Err	Z	P>/z/	95% Conf.	Interval
LOS	0.9999961	3.91e-07	-9.95	0.000	0.9999953	0.9999969
LR	1.000008	1.00e-06	7.91	0.000	1.000006	1.00001
RPP	1.0789	0.0087362	9.38	0.000	1.061913	1.096159

Researcher's computation with SPSS, 2018

The analysis for the repayment capability model of microfinance banks in the table above shows that loan size, lending rate and repayment pattern have significantly contributed to repayment failure. This depicts that a unit increase in loan size, lending rate and repayment pattern significantly increase hazard ratio for loan repayment by 0.999, 1.000 and 1.0079 respectively at 1 per cent level of significance which implies the inability of the microfinance bank's clients to meet up with their instalment repayment. Though similar result was established in the study conducted by Idowu & Salami in 2010 where lending rates charged by microfinance banks in Ogbomoso were very high, and affected the loan repayment by hairdressers to the extent that income made by the hairdressers had not improved after collection of loan due to short repayment period attached to the loan but the study considered hairdressers only in their study while this study covered many other sectors of the economy. The result above rejects the null hypothesis and accepts alternate hypothesis which states that loan size has significant effect on repayment capability of microfinance banks' clients.

SUMMARY, CONCLUSION AND RECOMMENDATIONS

The relationship between loan size, repayment pattern, lending rate and repayment capability was further inspected with the cox regression approach. The estimated hazard ratio affords proof of a substantial influence of all the exogenous variables on repayment capability. It is perceived from the results that increase in loan size, lending rate and repayment pattern resulting to lower repayment schedules has the propensity of increasing the hazard ratio for repayment capability. In other words, client's incapability to uphold the instalment repayment could significantly be influenced by large loan size borrowed, high lending rate and multiple repayment schedules within a short range of time. Given the above result, the study therefore rejects the null hypothesis that loan size has no significant effect on repayment capability of microfinance banks clients which implies that loan size has a significant effect on clients' repayment capability. This proposes that the loan size borrowed by the microfinance bank's client, the lending rate and type of repayment schedule for the loan have significant influence on the ability of the client to pay instalment amount over the duration of loan repayment.

One of the major difficulties confronted by microfinance banks in their extension of loans to customers is that higher percentage of their borrowers are usually risky and low net-worth individuals with little or no collateral which in the event of default may affect the survival of microfinance banks. However, microfinance banks should make loan repayment patterns very flexible to avoid loan default though they may fear that repayment pattern flexibility endangers repayment quality, but it is remarkable for microfinance banks to have loan monitoring team to avoid diversion. The study therefore proffers the following recommendations for policy implementation:

1. Loan size given should be based on client's cash-flow, and financial capability

2. Microfinance banks should insist on graduated loan policy, they should start with small loan, when repayment is done, they can advance bigger loan
3. Effective monitoring of loan utilization should be done by MFBs follow-up team to avoid diversion of loan by the borrowers
4. The microfinance banks' loan policy should be revised by restricting the loan repayment patterns from weekly to monthly basis to create enough intervals for borrowers to pay –off their loans and interest conveniently.
5. The microfinance banks' lending criteria should be strictly adhered to by the staff for the appraisal of customers' loan requests before approval to avoid loan default, any erring staff should be sanctioned.

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