MICROFINANCE BANKS' LOAN SIZE AND DEFAULT IN SOME SELECTED MICROFINANCE BANKS IN LAGOS STATE, NIGERIA

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Abstract

The study investigated the extent to which loan size has contributed to default rate of MFBs borrowers in Lagos State having a population of one hundred and seventy eight with a sample size of twenty microfinance banks located in the state capital. Two hundred copies of questionnaire were administered while one hundred and eighty two were returned for analysis using linear regression.It was found out that loan size and instalment size play significant roles in greater risk of default than lending rate. A unit increase in loan size and instalment size increases harzard ratio by 1 unit at 1 per cent level of significance. The result thus indicated unfavouarable survival rate for the micro finance clients which implies that the loan size could significantly result to increase in risk associated with client's non -repayment. This shows that the effect of loan size and the instalment size during loan default is highly significant such that the higher the loan size and instalment size, the more the risk associated with it during a period of default. However, lending rate seems not to play a dominant role in influencing loan default though it could contribute to loan failure but not significant as expected. It was suggested that loan size should be based on certain percentage of a borrower's net income.

Keywords: loan size, default rate, instalment size, repayment pattern, repayment period

1.0 INTRODUCTION

Microfinance is described by the Central Bank Nigeria (2005) as the delivery of financial services to the underprivileged, underserved by the traditional financial institutions (deposit money banks) as captured by Jaffari, Saleem, Kaleem, Malik & Raza (2011) and Conroy, (2003). Some of the features that differentiate microfinance banks from commercial banks' services are; (i) absence of collaterals; (ii) little credits extension and deposits collected, and (iii) simple banking procedures (Iorchir,2006).

These financial services offered by the microfinance banks in Nigeria comprise deposits, loans, micro

leasing, payment services and money transfer (Eboh,2008). Extension of credit and other basic financial services to the economically active, low-income families and their trades is a microfinance policy that relieves poverty attained by the upsurge of the underprivileged income, building a feasible business, reducing vulnerability to shocks and creating occupation (Yunus,1999).

The needed finances through informal microfinance methods like Self-Help Groups (SHGs), Rotating Savings and Credit Associations, (ROSCAs), Accumulating Nigerians have always provided credit and Savings Associations (ASCAs) and direct borrowings from friends and relations among themselves before the advent of microfinance (Babajide, Taiwo, and Isibor 2015). The dearth of loanable funds has restricted outreach of microfinance services to few people by the informal financial institutions as pointed out by the Central Bank of Nigeria (CBN, 2005). To resolve this acknowledged paucity of the informal microfinance sector, microfinance strategy was put in place by the Central Bank of Nigeria in 2005 (amended in 2011) as a prelude to the authorising of microfinance banks in Nigeria

The failure of microfinance institutions in satisfactorily bridging the gap of not extending financing essentials to the underprivileged and low-income groups led to the establishment of microfinance banks in Nigeria (Acha,2008). The endorsement of microfinance banks was justified by the Central Bank of Nigeria with the absence of institutional capability and weak capital base of existing community banks, the existence of the massive under-served market and need for enlarged savings opportunity (CBN, 2005).

Research Question:

To what extent does loan size contribute to the default rate of microfinance bank's borrowers in Lagos State?

2.0 LITERATURE REVIEW

2.1. Information Asymmetry Theory

The borrower's probability to have more statistics than the lender about the risks of the venture for which they receive funds is the concept upon which this theory's component is grounded which leads to the hitches of adverse selection and moral hazard. The productivity of fund transfer from surplus to deficit units is lessened by these difficulties. These problems are overcome by banks in three respects: firstly by long-term interactions with customers through provision of assurance, secondly by distribution of information and thirdly through deputized borrower's monitoring.

A delinquent loan means a late payment (CGAP, 1999). A loan becomes delinquent before being defaulted which depicts an insignificant chance of its recovery. The incapacity of a borrower to accomplish his or her loan commitment when outstanding is regarded as loan default (Balogun & Alimi, 1990). It is also the coincidence that a microfinance bank (MFBs) may not obtain its loan plus interest from borrowers (Warue,2012). Microfinance banks across the orb are encountered with the difficulty of loan defaults because most micro-loans are not collateralised which can degenerate the credit portfolio.

Adedapo (2007) defined loan default as the borrower's incapability to justify his loan responsibility when payable. Microfinance banks attempt to avert loan delinquency and default because non-payment of loan leads to loss of capital to the lender which will make banking operations no longer maintainable. The disappointment to meet the legal responsibilities (or conditions) of a loan is regarded as a default.

Debt services default and technical default are the two categories of default. Not being able to make a scheduled payment of interest or principal refers to debt service default while technical default is when a confirmatory or a negative covenant is dishonoured. Loan default is non-punctuality in the payment of interest or principal when outstanding. The default is the financial impotence of a debtor to meet the lawful obligation of debt repayment. Ledgerwood(2000) defined default as a borrower's inability to make his mandatory payment or a reluctance to honour his debt while delinquent loans are loans that have become due and not received which becomes defaulted when the chance of its recovery is very slight. Generally, loans that are in arrears are past due and belated having become outstanding and have not been paid. Default is the debtor's failure to meet his or her legal obligations according to the debt contract or dishonouring a debt contract of a loan agreement (Ameyaw-Amankwah, 2011). The default is the reluctance and incapability of a debtor to pay his debt. Loan default occurs when the borrower fails to make obligatory payments or in some other ways debtor's non-conformity to the terms and condition of a loan (Murray, 2011)

The helplessness of a borrower towards the non-accomplishment of his or her loan commitment as at when due is described as loan default (Balogun&Alimi1990).Some of the influences connected with default as stated by Kazosi (1998) include other financial intermediaries' reluctance to oblige small borrowers' financial needs; not recycling funds to other borrowers; and creation of disbelief. The lender and borrower would bear

the costs of loan delinquencies, the costs in delinquency situation for lender include loss of interest, legal fees, opportunity cost of principal, and other related costs while for the borrower, default is a trade-off between the drawbacks in integrity loss versus the opportunity cost of investment forgone due to current loan work-out.

Baku and Smith (1998), Berger and De-Young (1995) in India acknowledged that default from the industrial sector point of view is caused by selection of an unsuitable entrepreneur, defective project appraisal, collateral security/equitable mortgage inadequacy against loans, improbable repayment patterns and loan terms, absence of loan monitoring measures, and natural mishaps.

It was exhibited by Okorie (1996) that loan default is caused by the type and time of loan pay-out, poor loan supervision and less enterprise profitability while other dangerous factors related to loan delinquencies are: loan term, lending rate; loan type; poor credit history; borrowers' income level and loan transaction costs but Okpugie (2009) identified extraordinary lending rate by the microfinance banks as a reason for the dreadful default.

Idama et al. (2014) commented that the persistence of credit risk is a hazard to the survival of microfinance banks.

2.2. Reasons for Loan Default

Default comprises borrower's loan digression, loan refund reluctance, combined with unruly neglect, and loan officer's inappropriate evaluation of borrowers (Ahmad, 1999). Corporate loan default is upsurged by declination in the real gross internal product, and that the repayment capability of borrowers is directly shaken by the exchange rate reduction (Fesolvalyi as cited in Kwakwa, 2009). The unwarranted government interference with the operations of government-sponsored credit programmes, loan deficiencies, loan delivery postponement, small farm size, extraordinary interest rate, the age of farmers, reduced supervision, and non-profitability of farm enterprises are the major sources of loan default (Balogun & Alimi,1990). Some impactful factors on farmers' repayment capability are farm scope, family size, job scale, living overheads and exposure to sound administration skills (Akinwumi & Ajayi,1990). Olomola (2002), stated that repayment performance could be unpleasantly affected by loan pay-out interval and the high interest rate that can meaningfully surge borrowing transaction costs. In Ondo State, Nigeria, it was discovered by Okorie (1996) that factors connected with loan delinquencies are loan type; loan term; lending rate; borrower's poor credit history; borrowers' income level and loan transaction cost while loan variety, pay-out period, regulation, and enterprise productivity are contributory factors to the repayment capability, and subsequently high default rates. Vandel in1993 instituted that great lending rates by banks lead to loan default by borrowers. Predominantly, non-performing loans occurred by an inevitable number of incorrect economic choices by entities, and basic misfortunes (harsh weather, unanticipated change in prices for definite products, etc.) (Gorter&Bloem,2002). One of the fundamental causes of Japan's elongated economic slow recovery as specified by Nishimura et al. (2001) is problematic loans or non-performing loans which were experienced during the bubble era from some of the companies and industries by financial institutions that led to structural reforms deferment and the financial intermediary system prohibition. There are reasons for loan defaults which are government's prescription of interest rate ceiling; informal lender's monopolistic power execution in credit markets, poor supervision procedures, loan repayment refusal and digression; borrower's huge transaction costs for a loan application, difficult moral hazard and so on (Kohansal & Mansoori,2009)

Opposing macroeconomic blows together with the greater cost of capital and lesser interest margins are connected with a growing scope of problematic loans though there are contributory analyses and macroeconomic consequence on loan default in Sub-Saharan nations which exhibited that macroeconomic constancy and economic growth are linked with a diminishing level of default (Fofack, 2005)

Waweru and Kalani (2009) discovered that the national economic depression, reduction in the buying capability of consumers plus lawful issues were caused by non- performing loans among microfinance banks in Kenya while Sheila (2011) disclosed that non-challant attitudes of the loan officers about applicants' comprehensive financial base are a factor causing loan default, which would have alleviated risk of loss in case of default. In Uganda, scanty loan provision, illiteracy and insufficient funds are causes of loan default which are imperative that the loan officers jointly determine the fate of a borrower if the loan is to be given to him/her or not; but the inadequate loan causes danger for the business which leads to default (Sheila, 2011)

A greater percentage of microfinance banks' clients are involved in traditional, low income generating trades and infrequently differ these trades and expertise which deduces that they have little awareness about diverse merchantable abilities that can be profitable when industries are not operational. Also, most industrialists are complete stark illiterate who can neither read nor write to make modest calculations which

make them not to account for their industries to the extent that when a lender makes an error in loan repayment calculations, they are accountable likewise desertion of debtors and poor business training (Kasozi,1998).

Every microfinance bank is involved in lending which is problematic to invite customers due to none availability of collaterals which make some of them crave for "just having borrowers" which is the reason for people's properties' seizure.

Bichanga and Aseyo (2013) disclosed these factors for loan default which are insufficient monitoring by microfinance banks of the micro and small enterprises' owners, bank's delays in processing and paying-out loans, loan digression, prolonged loan approval where all loans are to be ratified by the Area/Head Offices.

In Kenya, Nguta & Guya (2013) disclosed that business type as cause of loan default, it was further revealed that highest loan repayment defaults were common in the manufacturing sector to the tune of (67.9%); service industry (64.0%); agricultural sector (58.3%) while the trade sector had the least (34.9%) loan repayment default which was accredited to high demand of products as a result of good business performance which increased profitability and minimised default rate.

2.3. Reduction of Loan Defaults

The classification of bad credit by Golden and Walker (1993) were characterised by 5Cs to safeguard bad loans or the defaulted loans which are complacency, carelessness, communication, contingency and competition. Complacency is an assumption based on using past achievement to judge future success that is, great reliance on guarantor's past financial status, dependence on past reported financial net worth or past loan repayment records of customers. Carelessness contains reduced underwriting classically demonstrated by a deficiency in loan documentation, the absence of current financial proof or other germane evidence in the borrower's credit files, and non-existence of defensive promises in loan agreement. Communication incompetence is a breach in conversation on bank's credit practice and canons to the customers before loan hitches rise. The loan guidelines must be meritoriously communicated and imposed on loan officers by the management while credit officers should notify the management about complications encountered with current loans as soon as possible. Contingencies denote lender's disregard about situations that might result in loan default, working out a loan without considering the risk involved. Competition encompasses imitating competitors' behaviour rather than maintaining the lending canons, that is, emulating other lenders' deeds that are not sensible business exercises. There should be proper monitoring of loan repayments while quick steps should be taken when a customer defaults.

Numerous institutional mechanisms like collateral pledges, credit guarantee by third-party, credit rating, and collection teams were devised by lenders aimed at reducing loan default risk likewise adequate loan monitoring by microfinance banks, renegotiation where is a perception of problematic loan as well as avoidance of loan extension to highly risky customers (Kohansal & Mansoori,2009)

3.0 METHODS AND DATA

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 extent to which loan size has contributed to the loan default rate among microfinance banks' borrowers in Lagos State.

The survey research method was adopted for this study. The success of loan repayment is tied to three variables -loan size, repayment pattern and lending rate. In total, two hundred copies of the questionnaire were administered to microfinance banks' clients (borrowers) in Lagos State, Nigeria as respondents while one hundred and eighty-two were returned. Data were collected within 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 the questionnaire to fill. Section A of the questionnaire comprised of the biodata of each respondent while section B comprised of three constructs on loan size, lending rate and instalment amount. A five-point Likert scale measurement was used which were Agreed, Strongly Agreed, Indifferent, Disagreed and Strongly Disagreed

3.1 Model Specification

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

LDR= f (LOS, LR, INST) …….. (1)

Equation (1) in its explicit econometric form is represented as;

$LDR = \alpha_0 + \alpha_1 LOS + \alpha_2 LR + \alpha_3 INST + \mu_t$…….. (2)

Where;

LDR is Loan Default Rate

LOS is Loan Size

LR is Lending Rate

INST Instalment Amount

α_0 is the constant term

$\alpha_1 \ldots \alpha_3$ are the slope coefficients

3.2 Measurement of Variables

As mentioned earlier, data for the study were collected using a 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.

4.0 RESULT PRESENTATION AND DISCUSSION

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 a greater proportion of the study.

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. 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. 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%).

Table 2 Cox Regression Estimates for Loan Default Rate

Variable	Haz.Ratio	Std. Err	Z	P>/z/	95% Conf.	Interval
LOS	0.9999979	4.81e-07	-4.41	0.000	0.9999969	0.9999988
LR	1.00001	1.42e-06	0.52	0.605	0.9999979	1.000004
INST	1.000014	2.44e-06	5.85	0.000	1.000009	1.000019

Researcher's Computation with SPSS, 2018

The loan default rate was expressed as a function of loan size, lending rate and instalment size which were

estimated using Cox regression with the estimated coefficient from the hazard ratio as shown in table 2 above. The table shows the individual effects of the loan amount, lending rate and instalment payment on the rate of default. Further evidence from the result table shows that loan amount and instalment size plays a significant role in the greater risk of default than the lending rate. A unit increase in loan size and instalment size increases hazard ratio by 1 unit at 1 per cent level of significance. The above result thus indicates unfavourable survival rate for the microfinance clients. However, lending rate reveals no significantly greater risk for default rate. This implies that the loan size could significantly result to increase in risk associated with client's none repayment. This shows that the effect of loan size and the instalment size during loan default is highly significant such that the higher the loan size and instalment size, the more the risk associated with it during a period of default. However, interest rate seems not to play a dominant role in influencing loan default though it could contribute to loan failure but not significant as expected.

The result from the study reveals a significant effect of loan size and instalment amount on loan default. It was observed from the instalment size and loan size estimated hazard ratio that high loan size and instalment amount increases the likelihood of loan default. This could be explained that in periods of loan failure the individual borrower may find it more difficult to repay large loan size with the accumulated instalments over time compared with the person that has small loan size with lower instalment attached to it. Hence, the higher the loan and instalment the higher the hazard ratio associated with the default rate. From the empirical result of the study, it could be concluded that loan size and instalment size have significant effects on loan default. Thus the null hypothesis stating that loan size has no significant effect on loan default rate rejected while the alternative hypothesis is accepted that loan size has a significant effect on default rate.

5.0 SUMMARY, CONCLUSION AND RECOMMENDATIONS

It was discovered that high loan size, high instalment size can contribute to loan default and as such increase credit risk, increase in lending rate, loan size and shorter repayment schedules increase hazard ratio as indicated in the study.

Microfinance banks in Nigeria are confronted with many challenges in their extension of the loan to customers, one of which is that higher percentage of their borrowers are highly risky since they are typically low net-worth individuals with little or no collateral which in the event of default which may affect the survival of the microfinance banks by implication. Huge non-performing loan affect the quality of asset of the microfinance bank which ultimately affect the microfinance bank's sustainability (Babajide, Taiwo and Adetiloye, 2017). However, microfinance banks should make loans repayment patterns very flexible to avoid loan default though they may fear that repayment pattern flexibility jeopardises repayment quality, it is noteworthy for banks to have Loan Supervision Team, Collection/ Recovery Team as strategies to monitor loans being disbursed to borrowers.

-Loan size should be based on financial capability and it should be a certain percentage of regular net income of a borrower to minimise default rate

- A larger loan size should be given to borrowers who have regular/steady sources of income generation with collateral or substitutes to minimise default rate

-The microfinance banks loan policy should be reviewed by restricting the loan repayment patterns to weekly and monthly basis to create enough interval for borrowers to pay –off their loans and interest conveniently

-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 which will reduce the default rate.

-Effective monitoring of loan utilisation should be done by microfinance bank's follow-up team to avoid diversion of the loan by the borrowers to other things, this will reduce default rate.

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