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EFFECT OF MICROFINANCE BANKS' INTEREST RATE ON LOAN REPAYMENT CAPABILITY OF BORROWERS

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ABSTRACT: *This study examined how microfinance banks' interest rate on loan affects repayment capability of borrowers in Lapo microfinance Bank. This study examined factors affecting loan repayment plan of borrowers; with a view on the impact of promptness of loan repayment on Micro Finance Insittution sMFI loans; and find out measurse put in place by MFsI to improve repayment plan of borrowers. Lapo Bank borrowers in Osun state branch participated in the study. A sum total of 110 customers of Lapo microfinance bank participated in the study. A structured questionnaire adapted from previous studies and grounded literature review was used in collecting data. Findings from the study showed that: there is significant effect of high interest rate of MFI on the repayment plans of borrowers' loans, the frequency of loan repayment plan significantly has effect on borrowers' ability to payback loan, there is significant difference in the perception of borrowers on effect of high interest rate of MFI on the repayment plans of borrowers' loans based on gender and educational level. Also, the descriptive result showed that; Majority of the borrowers agreed that high interest rate affect loan repayment, it implied that Lapo and other microfinance bank interest rate on loan is higher compare to Deposit Money Banks. Majority of the participants believes that a single digit interest rate on loan could easy the paying back of loan. The study recommends that: Since default on loans is linked to high interest rate, MFIs should consider looking into their interest rates to encourage prompt pay menrt. This may be weighed with interest rates of Deposit money banks and made relatively lower to encourage borrowers of MFIs. KEYWORDS: Microfinance, Interestrate, Borrowers, Loan.*

KEYWORDS: microfinance, banks, interest rate, loan, repayment, borrowers

INTRODUCTION

Dating back to the early 19th century a lot of informal financial institutions existed for the purpose of savings mobilisation from then over time thes metamorphosised into listed cooperatives in he 1950s and by the 1990 we had the existent of communtiy banks (CBN, 2005). By 2005 communtiy banks were licensed to convert to Microfinance Banks(MFBs) with a total minimum capital base of twenty million naira.. The idea behind the licencing of Microfinance Banks was to make financial services assessible to the grass root (Lemo, 2006). Thus, targeted at majority of the economically actively poor geared to; generate jobs, alleviate poverty. However, challenges of loan repayment as at when due has been a major issue of formal financial institutions in Nigeria most particularly the microfinance banks as

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they extend lending to the grass roots (Babajide, Taiwo & Isibor, 2015). This implies that survival of these MFBs is largely tied to ability to recover loans when they are due. It becomes imperative for the survival of a microfinance bank to ensure that the risk associated with loan non repayment is reduce to a minimal level. Thus, ensure adequate measures and policies are in place to ensure loan repayment when due. This does not hinder the giving of loans which will promote econimic growth but ensuring that this loans are recoverable when due. A non-performing loan will most likely affect the profitability of a microfinance bank which goes to affect its overall financial performance as funds available to borrowers will be limited when there are non-performing loans. It is critical to look into the repayment of loans to micro credit institutions so that their survival is not threatened. Microcredit are a useful tool for improving welfare of the society at large which is provided by MFBs (Asanke 2015)
Non-performing loans in microfinance banks without a doubt have to a large extent had their own ups and downs. This could be seen in the closure of over nine hundred MFBs in 2009 due to various challenges ranging from issues of non-repayment of loans to liquidity issues (CBN, 2013). In addition, the lack of a strong capital base of prevailing microfinance banks could not sufficiently guard against the risk of lending to microfinance banks' clients. As such there is the dread of depositing monies in microfinance banks by its clients. This is in consideration of the concern of banks becoming insolvent due to the low paid-up capital. In order to curb the issues on non loan repayment, collateral was introduced as a means to ensure loan repayment. The collateral is placed in the hands of the MFB at the time of granting the loan to stand as substitute for the loan repayment in the event of default. However, it is not all loans that require collateral. It is dependent on the policies of the MFBs (Adu, 2013).

In spite of the multitude of plans set up to guarantee the supportability of MFBs in Nigeria, the high disappointment rate calls for concern. The challenges of MFBs are traced to helpless practice and wasteful conveyance of microcredit. In some other cases low technical capacity and incompetent staff. However, very few studies have investigated issues around credit organisation and its management. This makes a genuine examination into microfinance administration, mamagement and loan repayment the executives of which this review looks to proffer suggestions. This review, accordingly, fills the gap in the writing on the effect of the loaning rate on the reimbursement ability of microfinance banks borrowers (Nwanyanwu, 2011; Acha, 2012). This study seeks to answer the question; how does lending rate affect the repayment capability of micro-borrowers in Nigeria?

LITERATURE REVIEW

Microfinance organisations provide micro credit to their customers. Microfinance can be referred to as little advances or microloan proposed to destitute individuals or those people who have extremely low pay or are independently employed (Olanike & Adebola 2014). As indicated by the subsequent definition, aside from the limited quantity of advances given out, different administrations identified with money like credit, investment funds, protection and asset moves are additionally considered as significant parts of microfinance. Taking

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everything into account, the audit of past studies seems to show that a large portion of the investigations will quite often mostly research microfinance as little advances by poor people.

According to Armendariz, de Aghion and Morduch (2000) loan management seeks to bring to barest minimum the risk associated with non-repayment of loan. Repayment is the act of paying back cash previously obtained from a lender. Repayment more often than not appears as periodic payments that ordinarily incorporate part principal in addition to interest in each payment. Failure to keep up with repayments of debt can make a person to be declared bankrupt and severely affect his credit rating. Kimando and Njogu (2012) posits that sometimes customers fail to pay their loans and the charged interest on the loan which may result to the risk of paying the loans late or not paying at all.

Interest rates on the other hard are the returns paid by a borrower (debtor) to a lender (creditor) for the use of money for a period, and they are expressed in percentage terms (Faure, 2013). Saurina (2014) defines interest as the amount a borrower pays in addition to the principal of loan to compensate the lender for the use of the money while Interest rates are the expressions of interest as a percentage of the principal.

Studies on credit reimbursement have over the course of the years zeroed in on macroeconomic and bank-related elements. Kinondo, Njongu and Kingoro (2012) examined the determinants of MFIs maintainability in the province of Muranga, Kenya. The aftereffects of the review introduced that the most elevated test is absence of reimbursement of loans which was acquired as was shown by 88 point nine percent of the absolute objective populace. It was likewise settled that numerous MFIs utilize an acknowledge apportioning device as a method for staying away from the unfavorable effects of individuals who have acquired from defaulting. In such manner, it is fundamental that some sort of assurance ought to be looked for by the MFIs prior to giving out advances. The determinants of credit repayment under the native monetary structure in southeast, Nigeria (Eze & Ibekwe, 2013). They used spellbinding measurements and different backslides to separate the data. The analyzed data uncovers that proportion of credit got, time of beneficiaries, house hold gauge, informational achievement, and occupation can affect on advance repayment.

As indicated by Bichanga and Aseyo (2013) study on the impacts of default on credits in the Kenyan microfinance foundations, the discoveries set up that there a few firms that depend on the bureaucratic or government and its representative to sponsor costs as a method for limiting monetary misfortunes happening from defaults on advances. Factors which fall in the middle of these two classifications have thus been given restricted consideration. Borrower qualities, however exceptionally indispensable in foreseeing the danger component of a credit, have not been straightforwardly inspected as it impacts the non-execution of an advance. There is an increasing need to understand exactly how lending procedures determine the probabilities of a loan becoming non-performing. Administrative rules for Deposit Money Banks contrast starting with one country then onto the next. Indeed, even

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with this distinction by and by, what all nations share practically speaking is the undertaking to set up great loaning rehearses, and have appropriate rules that will bring down the danger component of credits and enhance their exhibition.

The microcredit theory is the theory that anchors this study. The theory has its origin as far back as 1974 propounded by Melton. The crux of the theory is on the need for proper management of microcredit and also ensuring thhat a borrower's credit profile is well known before advancing credit. MFBs by providing loans contribute in a major way to economic growth (Olakojo & Olanipeku , 2011). Similarly, Maksudova in a study in 2010 studied noted that there is a positive relationship between microfinance lending and economic growth.This study hinges on the theory of microcredit. According to (Ibrahim, 2004) money loaning continuously encompasses some features of risks arising from situations which result from the failure to honour loan obligation when they fall due. The theory postulates that if collateral and other pertinent restrictions remain given, then it is only the lending rate that determines the amount of credit that is dispensed by the banking sector (Ogar, Nkamare & Effiong, 2015). Therefore, with an increasing demand for credit and a fixed supply of the same, interest rates will have to rise. Any additional risk to a project being funded by the bank should be reflected through a risk premium that is added to lending rate to match the increasing risk of default. Subsequently, there exist a positive relationship between the default probability of a borrower and the interest rate charged on the advance. It is thus believed that the higher the failure risks of the borrower, the higher the interest premium (Ewert, Szczesmy, & Schenk, 2000).

According to Saba, Kouser & Azeem (2012) who investigated the bank specific and macroeconomic variables of nonperforming loans in US baking sector from 1985 to 2010 period using OLS regression model. They considered total loans, lending rate and Real GDP per capital as independent variables. The finding reveals that real total loans have positive significant effect whereas interest rate and GDP per capital has negative significant association with NPLs. Also, Adela and Iulia (2010) in their study reported the link that exists between interest rates and non-performing loans. Roslan and Zaini (2009) investigates the impact of some borrower related characteristics, project related features together with loan related characteristics on loan repayment of agro bank micro credit scheme. The characteristics of the borrowers are (i) marital status (ii) occupation (iii) level of education (iv) race (v) gender (vi)age (vii) number of dependents, experience. The project related characteristics includes the project ownership structure, project type, project proximity to closest agro bank office, and revenue accumulated from the project. The loan characteristics include the loan amount and also the repayment period lengths. The data used in the study is a primary data, which is gathered through a survey carried out among agro-bank micro credit scheme borrowers in 86 branches of agro bank throughout Malaysia. Based on the statistical and theoretical analysis, they highlighted those various empirical studies may encounter challenges in drawing up a conclusion on the major impact of interest rate volatility on loan defaults. Also, the study establishes that borrowers that did not have any training in relation to their business have a higher probability to default.

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Bloem and Gorter (2014) found out that despite the fact that issues identifying with nonperforming loans may influence all parts, the most genuine effect is on financial foundations, for example, business banks and home loan financing establishments which have a tendency to have extensive loan portfolios. In addition, the expansive awful loans portfolios will influence the capacity of banks to give loans. Immense non-performing loans could bring about loss of certainty with respect to contributors and outside financial specialists who may begin a keep running on banks, prompting liquidity issues. Research discoveries and productions demonstrate that bad loans happen because of a few variables. Berger and DeYoung (2013) identified poor administration as one of the significant reasons for issuing loans. Borrowers in many banks with issue of loans do not practice sufficient loan endorsing, checking and control. A World Bank approach examine working paper on Non-performing Loans in Sub-Saharan Africa uncovered that bad loans are caused by unfriendly financial stuns combined with high cost of capital and low interest margins (Fofack, 2015).

Goldstein and Turner (2004) expressed that 'the aggregation of non-performing loans is for the most part owing to various elements, including economic downturns and macroeconomic unpredictability, terms of exchange crumbling, high interest rate, intemperate dependence on excessively costly between bank borrowings, insider loaning and good peril'. A few writers may also establish that poor loans may be as a result of issue statements. Rouse (2016) demonstrated using his study that issued credit may radiate from accounts which has negative balances and there is no negative balance restriction, negative balances are considered in the banks and has not been effectively used by the customers for quite a while and negative balances used in overabundance of sensible utilizable cut-off points. He additionally recognized lack of proper established aptitudes and a judgment with respect to the bank is a conceivable reason for bad loans.

Johannes (2016) carried out a study on the effects of interest rate spread on non-performing loans in Namibia. Employing unit root test, cointegration and error correction model technique on the quarterly data of banks covering the period 2001 to 2014. The findings show that interest rate spread has a positive and statistically significant effect on non-performing loans in Namibia. Furthermore, the study also showed that inflation has a positive though not statistically significant effect on non-performing loans in Namibia. These finding are similar to that of Warue (2013), Kamunge (2013) and Kanyinji (2014). The positive relationship between interest rate spread and non-performing loans implies that the higher the interest rate margins the higher the probability of defaulting on loans. The coefficient of inflation in Johannes (2016) study findings is also positive though statistical insignificant, meaning inflation also affects non-performing loans positively.

Furthermore, but for the timely intervention of the Banker of Banks ; the Central Bank of Nigeria, microfinance banks would habve gone into serious problems and folded up. There were numrous cases of fraudulent practices and poor management of funds across microfinance banks (Orodje, 2013). This was further confirmed in studies by Nwayawu (2013), on the problems and prospects of microfinance banks in Nigeria, ranging from

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improper regulatory structure, poor education of population, lack of adequate banking structure to incompetent hands in position of management (Nwayawu, 2013).

From the review of past studies, most focused on developed and developing countries. The studies conducted so far in this area of the effect of interest rte of MFIs on loan repayment gave more attention mainly to the relationship between interest rates and nonperforming loans in the commercial banking sector. Moreso, there seems to be an absence of knowledge for proper handling and management of Microfinance Bnaks by its owners, this goes a long way to also affect its relationship with customers which can in turn affect performance considerably. Amongst other things it is necessary for any microfinance bank to be able to meet its operaton expenses from the revenue it generates from services, where this is not the case it calls for concern and needs to be looked into for the sustainability of the bank. Other studies in line with loan repayment in MFBs have focused mainly on other developing countries excluding mostly Nigerian studies. Hence, a need to determine whether there exists a relationship between borrowing interest rate charges and loan repayments in MFIs in Nigeria. Few of the studies in Nigeria, however, have specifically focused on the linkage between interest rates and loan repayment. The studies conducted so far do not provide an integrated and holistic view on the problem of loan repayment in the microfinance banks. So much of the literature has not drilled down to specific causes attitude to loan repayment, assessment of credit worthiness' and other microeconomic variables. Also, majority of the studies focused on secondary data in making their assertions; however, this present study is adopting primary means of data collection to explain some of those factors that mitigate against repayment of loans among Lapo bank borrowers.

MATERIALS AND METHODS

According to the CBN, there are 916 microfinance banks in Nigeria as at October 2020. From this numbr 31 are locatd in Osun State. The broad objective focused on in this study was to examine the effect of interest rate on loan repayment capability of borrowers in MFBs. The study adopted the survey research design using a well structured questionnaire as research instrument to elicit primary data from borrowers of Lapo Microfinance Bank in Osun State, Nigeria. There are a total of 8 branches of Lapo MFBs in Osun State and purposive sampling waas used to select 3 branches. The population of the study was the entire branches of Lapo MFB which were 8 in number (LAPO 2018). From the questionnaire issued out a total of 110 questionnaires were returned and considered usable for this researchIn the questionnaire the respondents were required to rank each item in other of importance, A 5 point likert scale was used to to indicate importance. Section A of the questionnaire was used to obtain demographic statistics of respondents. While section B was divided into 4 parts containing a total of 20 questions to obtain information from respondents on the interest rate that applies to loans, factors that affect loan repayment and method of collection of loan due fro repayment.

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RESULT AND DISCUSSION

For the purpose of this study a total the 110 copies of questionnaire were prepared, only 108 were returned and found usable for analysis, which is approximately 98%. It is important to state that the questionnaire was ethically administered and that some respondents did not respond to all questions, leaving the total in some questions less than 110. Descriptive statistics were used to analyse date. The hypothesis formulated was analysed using chi-square. This was done to examine the infuence of interest rates charged by MFBs on loan repayment capability.

39.8% of the respondents were male while 60.2% were female. The results indicated that majority of the respondents were between the age bracket of 31-45 years of age. 13% of the respondents were ages between 31-35 years, 25.9% were ages between 36-40years, 46.3% were ages between 41-45 years, and 14.8% were ages between 46-50 years. Over half of the respondents had up to a tertiary education and almost half with up to secondary education. 57.4% of the respondents were married, 36.1%were single and 6.5% were others. This result implies that majority of the borrowers were married. In addition, over 50% of the respondents were self employed; 37% of the respondents were employed, 56.5% were self-employed while 6.5% were neither employed nor self employed.

Demographic Statistics

		Freq.(*n=108)*	**%**
Gender	Female	65	60.2
	Male	43	39.8
	Total	108	100.0
Age	31-35 years	14	13.0
	36-40 years	28	25.9
	41-45 years	50	46.3
	46-50	16	14.8
	Total	108	100.0
Marital Status	Married	62	57.4
	Single	39	12.2
	Others	7	
	Total	108	100.0
Qualification	No formal Education	4	3.7
	Primary Education	5	4.6
	Secondary Education	44	40.7
	Tertiary Education	55	50.9
	Total	108	100.0
Occupation	Employed	40	37.0
	Self employed	61	56.5
	Others	7	6.5
	Total	**108**	**100.0**

Field Survey, 2021

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Effect of High Interest rate of MFIs on loan repayment

Table 2 presents descriptive result of effect of high interest rate of microfinance banks on the repayment of loan. From the table 74.1% of the respondents strongly agreed that the interest rate of microfinance banks is high compare to Deposit Money Banks; the mean value obtained at 4.35 indicate that majority of the respondents choose strongly agreed while the standard deviation (Mean = 4.35, SD = 1.263) that is farther from mean values indicated that the data is normally distributed, 43.5% agreed that not requesting for collateral influences the high interest rate charged by microfinance bank loans (Mean = 3.47, SD = 1.256), 54.6% strongly agreed that borrowers default in paying back loans because of the high interest rate(Mean = 4.24, SD = .956), 48.1% strongly agreed that high interest rate could result in delayed repayment of loans(Mean = 4.22, SD = .980) and 67.6% strongly agreed that if the interest rate on loan is single digit (less than 10%) (Mean = 4.36, SD = 1.106), it may make paying back easy for borrowers. This result implies that high interest rate on loans affect the repayment.

Table 2

Descriptive result of effect of high interest rate of MFI on the repayment of borrowers' loans.

ITEMS	SD N(%)	D N(%)	U N(%)	A N(%)	SA N(%)	Total N(%)	Mean	Std Dev
The interest rate of microfinance banks is high compare to Deposit Money Banks	8 (7.4%)	7 (6.5%)	4 (3.7%)	9 (8.3%)	80 (74.1%)	108 (100.0%)	4.35	1.263
Not requesting for collateral influences the high interest rate charged by microfinance bank loans	12 (11.1%)	14 (13.0%)	14 (13.0%)	47 (43.5%)	21 (19.4)	108 (100.0%)	3.47	1.256
Borrowers default in paying back loans because of the high interest rate	0 (0.0%)	6 (5.6%)	21 (19.4%)	22 (20.4%)	59 (54.6%)	108 (100.0%)	4.24	.956
High interest rate could result in delayed repayment of loans	0 (0.0%)	14 (13.0%)	0 (0.0%)	42 (38.9%)	52 (48.1%)	108 (100.0%)	4.22	.980
If the interest rate on loan is single digit (less than 10%), it may make paying back easy for borrowers	3 (2.8%)	10 (9.3%)	5 (4.6%)	17 (15.7%)	73 (67.6%)	108 (100.0%)	4.36	1.106

Field Survey, 2021

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Test of Hypothesis

There is no significant effect of high interest rate of MFI on the repayment plans of borrowers' loans.

Table 3:Chi square result of effect of high interest rate of MFI on the repayment plans of borrowers' loans

Variable	Mean	Std. Deviation	N	Chi Square	Asymp. Sig.
Questionnaire items 1-5	21.67	1.82915	108	118.556	.000

Table 3 presents chi square result of effect of high interest rate of MFI on the repayment plans of borrowers' loans. The mean value (M = 21.67) indicates an average score of items 1-5. The standard deviation (SD = 1.8294) result obtained indicate that individual score obtained does not differ from mean. Which indicate that the data is normally distributed. From the table, the chi square value obtained at 118.56 is statistically significant at 5%. Therefore, the null hypothesis which states that there is no significant effect of high interest rate of MFI on the repayment plans of borrowers' loans is hereby rejected and it is concluded that high interest rate of MFI significantly affects repayment of loans by borrowers.

CONCLUSION AND RECOMMENDATION

Microfinance banks play a critical role in making money available at the grassroots to reduce the level of pverty as such MFBs providing microfinance would provide for sustainable development. Thus the availability of the microfinance is necessary and should be not ne hampered by high interest ratesThe study concluded that microfinance bank's interest rate is higher than Deposit Money Banks with a shorter repayment period which invariable could lead to default in repayment. The rate of interest on loans charges leads to failure to pay in time. Also, the most preferred repayment frequency is monthly compared to other available scheduled payment plan.

Furthermore, the key indicator of financial execution and proficiency of business banks is the spread between loaning and deposit rates. On the off chance that this spread is large, it fills in as an obstacle to the extension and improvement of financial intermediation. This is on the grounds that it disheartens potential savers because of low profits for stores and therefore restricts financing for potential borrowers. This has the far-reaching impact of decreasing achievable speculation openings and subsequently restricting future development potential.

Finally, it is concluded based on this study findings that loan size borrowed by Lapo microfinance bank's client, the interest rate, and type of repayment schedule for the loan have effect on borrower's ability to repay loan.

Recommendations

Based on this study findings, it was recommended that: since default on loans is linked to high interest rate, Lapo banks and other microfinance banks should charge a fair and reasonable rate which the short-term borrowers ca affords and the same time avoid risk of default in the long-run.

Lapo banks and other microfinance banks should partner with credit reference bureau such as Aset Manangement Company of Nigeria (AMCON) or Central bank in ensuring that information is communicated and shared on the loan defaulters in all financial institutions in the country. Lapo bank and other microfinance bank should not only give loan based on borrowers presented collateral but should scrutinize the borrowers' credit history. The size of loan to be given to a borrower should be based on the borrowers' cash flow and financial aptitude. Effective monitoring of loan utilization should be done by Lapo bank follow-up team to avoid diversion of the loan by the borrowers. This study focused on the effect of Microfinance banks' interest rate on loan repayment capability of borrowers using Lapo microfinance bank as a case study. Others studies should encompass other microfinance banks to determine the relationship between interest rate and the loan repayment capability of borrowers.

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