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Factors Affecting Loan Repayment among the Customer of Microfinance Institution: A Case of East Arsi Zone Dera Branch

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Abstract

This study aimed to identify and analyse the factors affecting loan repayment performance of borrowers through the use of questionnaires and interview schedules. To do this, three Microfinance Institutions (MFIs) from East Arsi Zone Dodota Woreda dera branch were selected and 209 borrowers and 6 MFI Employees were chosen from the total 2500 borrowers served. Descriptive statistics analysis was employed to estimate the model and analyse the findings. The results showed that variables such as sex, group borrower collateral, double loan, and supervision of loan utilization had a negative influence on loan repayment performance. Additionally, it was found that the extensive involvement and interference of a third party in the screening of borrowers by the lending institution was a factor in defaults. It was recommended that the lending institution should focus on group borrower collateral systems, double loans from different MFIs, loan utilization of borrowers, screening of borrowers, loan product, and technical support needs of the target borrowers, as well as better awareness creation to organize more viable borrowers, close supervision and follow-up, and strengthening internal and external weaknesses through better integration, keys, partners, and similar MFIs and stakeholders.

Keywords: Microfinance, Double Loan, Loan, Loan Repayment and Loan Borrowers

1. Introduction

Ethiopia has been one of the world's poorest and lowest-income countries for decades. This economic decline has been attributed to both internal and external factors, such as high poverty, famine, and unemployment rates. To combat this crisis, the government of Ethiopia has implemented various recovery strategies, one of which is the introduction of microfinance services to unserved or underserved populations. According to Abafita (2003) [1], relying solely on these recovery techniques to reduce poverty is insufficient; the private sector must also be expanded to create self-employment opportunities. Microfinance is the most effective approach to overcoming economic hardship and poverty, as noted by Professor Mohammed Yunus and Grameen Bank. The establishment of sustainable and profitable microfinance institutions, which serve a large number of people and have a high repayment rate, is the most critical component of Ethiopia's strategy to combat poverty.

Microfinance has been presented as a key strategy to combat poverty in developing countries (Fikirte, 2011) [22]. Proponents of micro-credit, such as Professor Muhammed Yunus and Grameen Bank, argue that it provides small people with the means to break free from poverty (Microfinance and Micro-credit, 2016) [26]. The success of Grameen Bank in this area has inspired numerous microfinance institutions around the world. Governments and non-governmental organizations likewise view microfinance services as an effective tool to reduce poverty, boost income, increase productivity, supply quality inputs to the market, and promote food security (Alemayehu, 2008) [12]. Bayeh (2012) [15] also affirmed the potential of microfinance institutions to alleviate poverty and increase access to financial services. Microfinance Institutions in Ethiopia at the presence of well-educated and skilled youth in the country's economy was not enough to provide financial services to the target poor population through conventional commercial banks. Collateral requirements and information asymmetries imposed by these banks have prevented a large number of people worldwide from accessing formal banking services (Litenah, 2009). Microfinance institutions (MFIs) were created to serve the financial needs of the unserved and underserved poor who have the potential to work hard and improve their lifestyle. Their main objectives are to create jobs, reduce poverty, empower women, and promote small businesses (Bayeh, 2012; Tolosa, 2014) [15, 34]. Since the late 1990s, microfinance institutions have been operating in Ethiopia as an economic development tool to benefit low-income people (Bayeh, 2012) [15]. According to Mengistu (2007) as cited by Abafita (2003) [1], urban credit financing schemes were initiated in 1994 to empower poor

households. This led to the Government of Ethiopia taking action to create regulatory frameworks to ensure the operational activities of similar industries. Consequently, Proclamation No.40/1996 was enacted to govern the activities of microfinance institutions (Abafita, 2003) [1]. These institutions are monitored and regulated by the National Bank of Ethiopia and provide financial services to farmers and entrepreneurs engaging in micro and small-scale businesses in urban and rural areas (Abreham, 2011) [10]. The Government sector, FeMSEDA, has taken initiatives to organize and facilitate financial services to MSE members through microfinance institutions. However, banks may face difficulties in collecting loan amounts with interest charges from borrowers according to contractual agreements.

2. Statement of the Problem

The primary objective of MFIs is to provide financial services (credit and saving) to the poor in order to relieve financial constraints and help alleviate poverty. Microfinance institutions offer loans mostly to urban and rural peoples who cannot afford collateral to get loans from banks. Financial services in Ethiopia are characterized by a high urban concentration. To fill these gaps microfinance institutions provide credit to the poor, who lack access to formal credit from financial institutions. Although the performance of the MFIs in Ethiopia has been impressive since their establishment, they are not free of default problems. Argued that default problems destroy lending capacity as the flow of repayment declines, transforming lenders into welfare agencies, instead of a viable financial institution. Loan default may also deny new applicants access to credit as the microfinance institutions management problems augment in direct proportion to the increasing default problem. One indicator of effective MFIs is the loan performance of the borrowers. High repayment rates are associated with the benefits for both MFIs and borrowers. If there is a high repayment rate, the relationship between the MFIs and their clients would be good. In contrast, if there is a low repayment rate, both the borrowers and MFIs would be adversely affected. So, if the MFIs are not viable because of default problems, borrowers will not have access to loans and suffer from poverty, which affects the development of the country as a whole. The most common and often the most serious vulnerability in microfinance institutions is the chance that a microfinance institution (MFI) may not receive its money back from borrowers (plus interest). This studies on loan repayment are not a new research area. In fact, different researchers have conducted loan repayment performance in different times, but the results of findings are still debatable among different researchers. The previous Researchers have studied socio-economic factors, borrower's attitude, lenders factors, availability of adequate legal and technical support, internal and external factors and loan related factors. Hence, this study aims to identify factors that affects loan repayment among customer in MFIs in dera branch which the previous researchers were not touched such us group loan collateral of borrowers, double loan and from the previous researcher loan related and socio-economic factors because this problem are not solved still know in MFI in Dera branch, Oromia, Ethiopia

3. Research Questions

1. What socio-economic factors can influence repayment performance of borrowers in the study area?
2. What are the factors of collateral group borrower in repayment?
3. What is the impact of double loan on repayment?
4. What loan related factors do have influence on loan repayment performance of borrowers in the study area.

4. Conceptual Framework of this Study

It is shown in Fig 1, which illustrates the relationship between the dependent variable (loan repayment) and the independent variables (the determinant factors affecting loan repayment performance of Microfinance institution's loan beneficiaries). This relationship is depicted in the following diagram. Conceptual framework involves forming ideas about how these variables interact and showing those interactions diagrammatically.

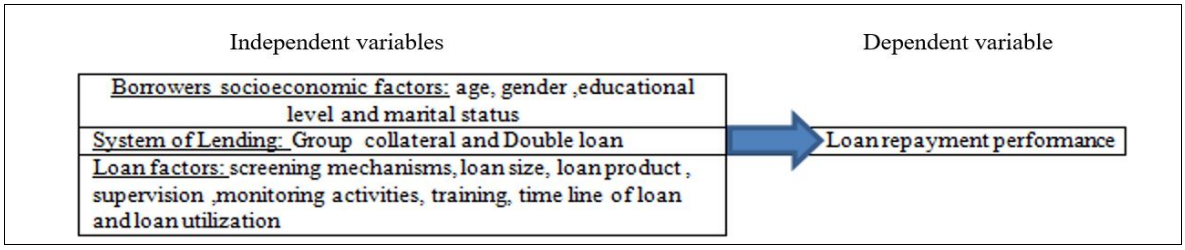


Fig 1: Conceptual frame work of the study

5. Related Work

The theorist Lysander Spooner was stated that the historical initiation of Micro financing service was traced back in the middle of 1800"s. Consequently he wrote the impact of the credit schemes on the target entrepreneurs and farmers while targeting the poor peoples to get out of the poverty. Meanwhile, the modern industry of microfinance service has been initiated since 1970 by Grameen Bank of Bangladish and pioneer Mohammed Yunus. Shore bank was the first microfinance and community development bank founded 1974 in Chicago. According to Prof. Mohammed Yunus and Grameen Banks phrases, an improvement in the economy and social welfare could partly realize through delivering micro-credits to the poor and people (Microfinance and Micro-credit, 2016) [26]. Hor Kimsay (2011) [24] reported that microfinance institutions were established originally as a non-for- profit making financial schemes that had particularly serves the poor (low-income groups of the society) at rural areas. As it was reported on this module, through time it was believed by some peoples in Cambodia that serving those poor peoples as non-profit making institute has its own impact on the financial sustainability of these MFIs to realize that the services would address a wide range of poor peoples in the country. As a result MFIs in the Cambodia has reviewed their credit scheme and tried to marginalize the services by commercializing their credit

schemes at lower interest rates than commercial banks. The reason for transforming the MFIs service into commercial is to bring the transparency of the financial services, increasing the confidence of donors and investors and to ensure that MFIs are financially sustainable to serve wide range of poor societies which demands financial services. Moreover, the author stated that the average loan sizes of MFIs were steadily increased from time to time based on the repayment experience of borrowers. However, through periods an increase in number of clients served and average loan sizes experiences some defaulted loans over couple of few years that leads the microfinance practitioners to review their implementation mechanisms and needs of new credit assessment methodologies that emphasizes on the micro and small-scale Enterprises (MSE). The assessment was focused on the cash flow assessment of borrowers rather than the collateral requirements which may fulfil the needs of MSE"s. An increase in the average loan size and change of loan approach to MSEs was the result of the increased capacity of lending larger loan size by MFIs. This theoretical literature review focuses on the concept of microfinance services from its beginning to its current role in the microfinance industry and its importance in poverty eradication and stabilizing high unemployment rates. It is believed that microfinance institutions were established originally as non-profit making financial schemes that served the poor at rural areas. The concept of microfinance services was first proposed by Lysander Spooner in the mid-1800s, and modern microfinance services were initiated by the Grameen Bank of Bangladesh and its founder, Mohammed Yunus, in 1970. In contrast, all microfinance institutions are intended to provide financial services in the absence of any collateral values unlike the formal commercial banks by delivering various microfinance schemes such as; micro credits, saving mobilization and provision of insurance schemes to the poor. The major objectives of these microfinance services are to strengthening the economic bases of the low-income generating activities of the poor peoples who are living in the rural and urban areas of the country (Fikirte, 2011) [22].

6. Research Design and Methodology

Dodota Woreda, the study area, is located in East Arsi Zone of Oromia Region, 125 km from Addis Ababa and 25 km from Adama City. According to the Administrative Office of Dodota, the Woreda's total population is 88,074, with 44,343 males and 43,731 females. Farming (crop production and animal husbandry) and off-farm activities such as fattening and petty trade are the main economic activities in the Woreda. Financial services to the poor are provided by three Microfinance Institutions (MFIs) and one Saving and Credit Cooperative Union (SCCU). Oromia Credit and Saving Share Company, Makilt Credit and Saving Finance Institution, Mataman Credit and Saving Finance Institution, and Keleta Saving and Credit Cooperative Union. Due to time and budget constraints, only three branches of the MFIs are chosen to explore the default problem in the zone. Oromia credit and saving institution, meklit and matamamn will purposely has chosen from 2,500 customers and MFI staff among the three micro finance institutions, as a study area for this research. For this study the researcher will use probability sample techniques that employed on simple random sampling to collect the required data from different sources. To get the above sample size of population the researcher uses the following sample size determination formula. Sample size will be estimated by the following formula (William G.Cochran, 1977).

$$n = \frac{Z^2\alpha/2\sigma 2}{e2} \quad (1)$$

Where:

$e2$ is marginal error,

σ2is population variance

Since population variance is not known use another formula

$$No = \frac{Z^2\alpha/2pq}{e2} \quad (2)$$

e is the desired level of precision, p is the estimated proportion of an attribute that is present in the population, and q is 1-p. The value for Z is found in statistical tables which contain the area under the normal curve, 95% confidence interval $Z\alpha/2$, α=0.05.

From the Z standard table Z0.025 =1.96, taking p & q equal proportion since the customers are homogenous so that p=0.2 and q=0.8 were applied and the marginal error e was limited to 0.05.

Then using formula 2;

$$No = \frac{(1.96)^2 0.2x0.8}{} = (1.96)^2 0.2x0.8 = 246,$$

$$\text{Since } \frac{no}{} = \frac{246}{} = 0.098, \text{ since it greater than 5\%}$$

$$0.05^2 \quad 0.05^2N \quad 2500$$

Once all data has been collected and cleaned, data analysis can be carried out to make sense of it. Depending on the type of data - qualitative or quantitative - different tools will be used. For quantitative data, frequency tables and statistical software packages such as SPSS version 22 - with its incredible capabilities and flexibilities of analyzing huge amounts of data quickly and generating simple and sophisticated statistical results - are employed. Qualitative data, on the other hand, requires an exploratory or conceptual approach, involving the analysis of open-ended questions (Walsh & Wigens, 2003; Wilson, 2010).

7. Validity and Reliability

Prior to administering the research tools to participants, a pre-testing process was carried out to guarantee that the questions were pertinent, comprehendible and made sense. This pre-testing was conducted on 10 respondents from the target population, chosen due to convenience as statistical conditions were not required in the pilot study (Cooper and Schindler, 2003). The purpose of this pre-testing was to refine the research tools in order to ensure that respondents in the main study would have no difficulty responding to the questions. Expert opinion was sought to assess the representativeness and appropriateness of the questions and to make recommendations for alterations to the structure of the research tools. This helped to enhance the content validity and reliability of the data collected. To guarantee the validity of the test, the researcher discussed the questions with a supervisor who was an expert in the field. The results of the pilot study were then used to measure the validity and reliability of the data that was collected. Shanghverzy (2003) found that reliability is a measure of

consistency, and this consistency can be improved by including many similar items on a measure, testing a diverse sample of individuals, and using uniform testing procedures. To ensure this, the researcher chose a pilot group of 10 respondents with similar demographics as those found in MFIs in the Dera branch and customers under the customer relationship managers, to test the reliability of the research instrument. This was done to address any inconsistencies that may arise from the instrument, guaranteeing that it was measuring what was intended.

Reliability Analyses

Table 1: Reliability Analyses

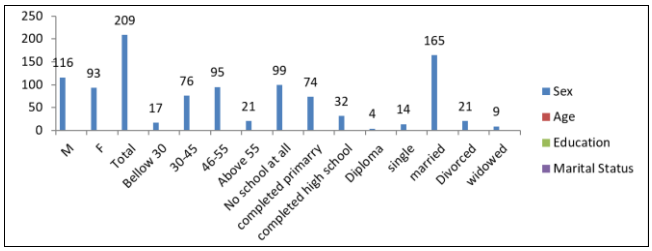
Scale	Cronbach's alphnuber of items	
1. Borrowers factors	0.651	4
2. Lending system factors	0.762	4
3. loan related factors	0.7112	4
Average (all scales)	0.708	

Klien (1999) demonstrates that the standard alpha value is 0.7, used as a benchmark for the studies. Cronbach Alpha was utilized for each objective which created a scale. Analysis of the table revealed that Lending System Factors had the highest dependability (α= 0.762), followed by Loan Related Factors (α=0.712) and Borrowers Factors (α=0.651). This demonstrates that all three variables were dependable as their reliability values exceeded the required threshold of 0.7.

8. Results and Discussion

The researcher distributed 224 questionnaires to collect primary data from sample borrowers of the three sample MFIS and 6 questionnaires to selected employees of MFIs. Out of the 224 distributed, 209 were successfully filled and returned back from borrowers and 6 from selected MFIS staff, resulting in a response rate of 93%. As a result, the research data presentation, analysis and conclusions were based on these responses, with the remaining 15 not being used.

Demographic Variables Description



Source: Author's survey 2023

Graph 1: Demographic information of the Respondents

This study aims to identify factors that affect loan repayment among customers of microfinance institutions in the East Arsi Zone Dodota woreda Dera Branch. Graph 1 provides the demography of the 209 selected participants, with 93 (43.7%) of them being female and the remainder 116 (54.5%) male. The majority of respondents 95 (44.6%) were between the ages of 46 and 55, followed by those between 30 and 45 at 76 (35.7%), above 55 at 21 (9.9%), and below 30 at 17 (8%). A majority of the participants were married at 165 (77.5%), with 14 (6.6%) single, 21 (9.9%) divorced, and 9 (1.4%) widowed. The educational level of borrowers showed that 99 (46.5%) were illiterate, 74 (34.7%) had completed primary school, 32 (15%) had completed high school, and only 4 (1.95%) had a diploma. This indicates that those with lower levels of education and no education used loans from microfinance institutions more than those with higher levels of education. The tables above indicate that the majority of borrowers were male and married, with most of them being uneducated and concentrated in the age range of 30-55. This demonstrates that the majority of borrowers were mature. It reveals that out of the 209 respondents, 65.5% (137) of them expressed discomfort with taking out multiple loans from different MFIs at the same time (Mean =.34, SD=.476). On the other hand, 34.4% (72) of the respondents agreed with this practice (Mean =.34, SD=.476). This suggests that the majority of borrowers do not support taking out multiple loans from different MFIs at the same time. Regarding the impact of multiple borrowing on repayment performance, 51% (105) of the respondents agreed (Mean =.50, SD =.50) and 49% (104) disagreed (Mean =.44, SD=.476). Those who agreed that multiple borrowing had an impact on repayment performance, 32% said that one of the main effects was using the funds for unintended purposes, 24% said that it resulted in accumulated and prior payment, and 41% agreed with both (Mean = 2.087, SD=.865). Over half of the respondents (53%) reported that they had successfully paid their debts, while 47% (Mean =.54, SD=.499) were unable to make payments because of being overburdened, using the funds for unintended purposes, or a combination of the two (Mean = 1.90, SD=.836). This shows that multiple loans have had a clear influence on the repayment performance of MFIs, requiring close communication between them in order to achieve their objectives. 54% of the respondents agree that the loan repayment and loan receive period is suitable, whereas 45% of them do not. Of those who disagree, 39% suggest that the period should be based on production time, 36% recommend an expanded interval, and 20% suggest a situational/conditional period. Regarding issuance of loan, 48.8% of the respondents believe that loans are not issued timely while 51.2% think they are. According to 49% of the respondents, the impact of delay for the repayment of the loan is price, 15% think improper use of the loan is to blame, and 34% believe both factors have an influence. 33% of the respondents have fully paid their loan, 37% have made it delinquent, and 23% have defaulted on it. The balance remaining/outstanding ranges from 1000-5000 for 25% of the respondents, 5000-10,000 for 39%, and 10,000-15,000 for 34%. In conclusion, loan related factors such as similarity of loan with intended purpose, amount of requested loan, feeling of receiving according to their intended request, and suitability of loan receive and repayment period have a great impact on loan repayment performance of MFIs.

It shows that 23% of the respondents believe that loan-based business activities are not worth it to generate profit, 28% are using the loan to pay for household expenses, 27% are using the loan to pay for other MFIs, and 22% are losing assets acquired by the loan (Mean = 2.479, SD = 1.069). Additionally, when looking at the purpose of the loan, 26% of the respondents used the loan for the purchase of raw materials for further processing, 25% for fattening, 30% for agriculture, and 19% for small and petty trades (shopping, baltina, and others) (Mean = 2.41, SD = 1.07). When asked

if the loan was enough for the intended purpose, 57% said yes, while 43% said no (Mean =.569, SD =.496). For the unsatisfied customers, the range of loan amounts requested was between 6000-10,000 (23%), 10,000-15,000 (46%), and 15,000-20,000 (31%) (Mean = 2.088, SD.73). Regarding the amount spent on non-intended purposes, 42% spent 10,000 Birr on fattening, 35% spent 6000 Birr on agriculture, and 23% spent 12,000 Birr on petty trades. The reasons for spending on other than the intended purpose were that the loan amount was not enough for the intended purpose (15%), the loan agreement did not coincide with the initial intention (23%), and not receiving the requested loan amount (62%) (Mean = 2.824, SD =.836). 53% of the customers of the selected MFIs were not supervised for proper utilization of their loans, while 47% were supervised. For loan repayment, 52% did not get enough supervision while 48% did. For those who were supervised, 13% were supervised weekly, 53% received supervision monthly, and 34% only received supervision every two months or longer. The average frequency of supervision was 1.86, with a standard deviation of .826. Most customers (82%) thought supervision was important for loan repayment, while 18.8% did not. Out of the 92 respondents, 55 (59.1%) did not benefit from the training that was intended to help them gain knowledge of credits, asset management, and increasing income. The mean score for those that benefited was .18 with a standard deviation of .38. Of those surveyed, 15 (27.27%) recommended that the training should be more timely, 25 (45.5%) suggested that the training should focus on business plans, and 15 (27.27%) recommended that the training should emphasize the benefits of taking out a loan. Of the respondents surveyed, 67% agreed that they provide regular training to their customers, while 33% disagreed. The purpose of the training is to help customers repay their loans on time (50%), and for other purposes (17%). The training is usually given before loan disbursement (83%), and sometimes after (13%). 100% of the respondents agreed that they supervise their customers once a month. 67% believe that the training given is sufficient, but 33% believe it is not, due to a shortage of resources. The other 67% did not provide an opinion. All of the respondents agreed that the credit screening process in their branch office is well organized, with a mean of 1.00 and a standard deviation of 0.00. When it comes to the effectiveness and efficiency of government body screenings for the lending institutes, the majority (83%) believe it is satisfactory, while 13% do not agree. Of those who disagree, 33% recommended removal of government interference, 33% proposed more clearly-defined screening criteria, and 34% proposed the hiring of skilled employees. All respondents also agreed that they visit clients' businesses each month, with a mean of 1.00 and a standard deviation of 0.00. The major challenges they face during loan repayment are borrowers disappearing (17%), inflation (33%), interest rates (33%), and borrowers' inability to repay due to drought or seasonal product offerings (17%).

9. Summary of Major Findings

This study assesses factors affecting loan repayment performance among customers of micro finance institutions in East Arsi Zone Dera Branch. Descriptive statistics were used to analyse the data gathered from 209 borrowers and 6 employees. The results showed that the majority of respondents were male, aged between 45-55, and many were uneducated. Furthermore, most loans were distributed to groups instead of individuals, and 88.26% of the group members knew each other. However, there were still some groups who did not know each other, which could have an effect on loan repayment. High rates of non-repayment are one of the main problems faced by financial institutions, and this study sought to identify the factors that contribute to this issue. Regarding the feelings of group borrowers about responsibility to other members in case of difficulty repaying their debt, 90% of borrowers reported feeling responsible and bearing the load and burden of their group members. Regarding taking of loans from different MFIs, 64% of respondents disagreed (Mean = .34, SD=.47), while 33.8% of respondents showed agreement. 50% of respondents agreed that multiple borrowing had an impact on repayment performance, while the other 50% disagreed. Of those who agreed, 32% stated that one of the greatest impacts was utilizing the fund for unintended purposes, 24% said it was explained as accumulated and prior payments, and the remaining 41% agreed on both of these impacts. 53% of respondents managed to pay their debts, while 47% were unable to due to being overburdened (39%), utilizing the fund for unintended purposes (29%) or a combination of the two (30%). Regarding loan disbursement and collection period, 55% of respondents agreed and 45% disagreed. The survey findings revealed that loan related factors such as the attitude of borrowers, loan product majority of borrowers used for agriculture, sufficiency of training, scarring of borrowers and close supervision, especially on loan utilization, have an impact on the loan repayment performance of Microfinance Institutions.

10. Conclusion

This study has revealed key insights into the factors influencing loan repayment among customers of microfinance institutions in the East Arsi Zone Dera Branch. Research was conducted based on archived data from the two independent groups of customers and employees of MFIs. Generally, the respondents were mostly male, aged between 30-55, married, and uneducated. Furthermore, the analysis revealed that more male borrowers were better at repaying their loans than female borrowers. Marital status was identified as a major determinant of loan repayment performance, with married respondents exhibiting higher repayment performance than single ones. Most of the loan is distributed to groups or members of groups rather than individuals. 88.26% of the group members know each other, but there are still members who don't which could have an influence on loan repayment performance. 90% of the respondents feel responsible and shared the burden of their group members. 84.51% of them have a fear of being sued if they cannot pay back the loan. Interviews were also carried out with selected MFIs managers, showing multiple access to different MFIs which can lead to misuse of funds. Price and location can also cause delays in loan payment, and the balance remaining/outstanding. 26% of the loan was used to purchase raw materials for further processing, 25% for fatting, 30% for agriculture, and 19% for small and petty trades (shopping, baltina, and others). It is known that continuous follow-up and close supervision is necessary for loan repayment, but the results of this study prove that the supervision done by MFIs is not sufficient. Supervision and follow-up must be done continually to ensure loan utilization and loan repayment.

11. Recommendations

Based on the major the findings of the study, the following are the recommendations proposed by the researcher:

- Lending institution should have more focus on female borrowers and single borrowers than married.
- Lending institution has developed system of borrower's collateral rather than group borrower's collateral.
- Taking care of group collaterals and developing system that can minimize loan default and delinquency.
- Before extending loan to customers, MFIs should have a well-organized ad coordinated way communication to each other so that they would easily identify those customers who take double loan without knowledge of either of the MFIs.
- An adequate training on effective utilization of loan/fund should be given to the customers and employees of the organization, a clear understanding of the rationale behind loan by borrowers and even employees play an important role in meeting the objective of the MFIs and the government thus awareness creation programs and activities should be strengthened on the importance of using loans appropriately and that default is a criminal offence, as well as providing special training to customers.
- The screening process should be independently performed by the MFIs themselves without the interference of government officials and any other personnel that have no relationship with the MFIs since this will enable the MFIs to exactly address and identify their customers based the criteria they set to test the creditworthiness of their customers.
- Providing different types of borrowing mechanisms and facilitating or arranging different repayment methods based the real situation of the borrowers.
- Adequately supervising customers especially on utilization of funds for intended purpose and repayment performance of borrowers.
- Creating continuous awareness through regular follow up and supervision using different Medias, workshops, seminars and forums.

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