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AN ASSESSMENT OF FACTORS DETERMINING LOAN REPAYMENT PERFORMANCE OF SMES IN GWARZO LOCAL GOVERNMENT – A REVIEW

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Abstract

The main objective of this study is to assess the factors that determines loan repayment performance of Small and Medium Enterprises (SMEs) in Gwarzo L.G.A of Kano state-Nigeria as SMEs are important sector in all economies, be it developed or developing, therefore, their performances affects economic development of any nation. However, there are so many credit facilities for SMEs in Nigeria which are meant to promote their activities. Most of these credits are granted without collateral, as such so many SMEs find it difficult to repay the loan on stipulated time which has effect on repayment performance. This study therefore, reviewed existing literature on the relationship between loan sizes, loan tenure, and interest rate, borrowers` attitude of money and loan repayment among SMEs in Nigeria. Based on the literature reviewed the study concludes that loan size, loan tenure, interest rate and borrower`s attitude of money have significant relationship with loan repayment among SMEs in Gwarzo LGA.. The study recommends that financial institutions should consider, loan size, loan tenure, Interest rate and borrower`s attitudes when giving loan to SMEs.

Keywords: *Loan Size, Loan Tenure, Interest Rate, Borrowers` Attitudes, SMEs Loan Repayment Performance.*

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1. Background to the Study

Small and Medium Enterprises (SMEs) are essential sector for delivering more development and growth of many countries because they are among the key players to strengthening the productivity in the economy as well as provide considerable positive impact on employment creation, innovation, productivity growth and competitiveness. SMEs form more than 99 percent of all enterprises in the world (Capital Markets Authority, 2010). SMEs also represent almost the totality of the business population, account for about 70 percent of total employment and generate between 50 percent and 60 percent of value added, on average (OECD, 2018). The Nigerian Micro, Small and Medium Enterprises (MSME) sector provide a total labor force of 59, 741, 211, representing 84.02 percent. It also contributed about 48 percent of the national GDP in the last five years, with a total number of about 17.4 million, they account for about 50 percent of industrial jobs and nearly 90 percent of the manufacturing sector, in terms of number of enterprises (SEMEDAN & NBS 2015).

However, SMEs finance is one of the most important aspects in SMEs literature. In 2017 financial period, Bank of Industry's (BOI) provided the total loan of over N112.5 billion to SMEs (Dikko, 2018). The managing Director of Development Bank of Nigeria (DBN), Opanachi (2018) also asserted that the Bank made N5 billion available to three (3) MFBs to fund several SMEs across the country. This shows the commitment of government in trying to promote SMEs activities in Nigeria. Therefore, one of the most important thing to look at, is repaying the amount of loan back by such SMEs since most of them acquired such loans without presenting collaterals, this makes most of them unwilling to repay the loan (Shu-Teng, Zariyawati, Hanim & Annuar, 2015). Consequently, high rate of default arising from poor management procedures, loan diversion and unwillingness to repay loans has been threatening the sustainability of MFIs as well as SMEs in Nigeria (Awoke, 2004; Brown, 2008; Edet, Agbachom, Igiri & Sampson, 2016). As such this paper specifically is aim to discuss issues and concept on the determinants of loan repayment performance among Nigerian SMEs.

2. Conceptual Review

2.1. Small and Medium Enterprises (SMEs)

Several institutions and agencies define SMEs differently using parameters such as number of employees, assets base, turnover, working capital and financial strength. OECD, (2017) considered SMEs as business employing up to 249 persons, with the following breakdown: Micro Business is one whose employing 1-9 workers, Small is one with 10-49 employees, while Medium as one with 50-249 employees. Equity Investment Scheme (SMIEIS) also defines SME as any enterprise with a maximum asset base of N500 million excluding land and working capital and with the number of staff employed not less than 10 or more than 300 (CBN, 2005).

2.2. Loan Repayment

Loan repayment is the distinctive way of paying off the debt balance on a loan over a period of time with no any additional principal paid on the balance. In other way repayment can be in a lump sum with interest at maturity. Therefore, repayments is said to be when both principal and interest are up to date in accordance with the agreed repayment terms deemed to be performed (Nawai & Shariff, 2013; Obamuyi, 2007). However, loan repayment defaults are when a borrower could not or will not pay back his or her loan and when the MFI no longer expects to be repaid (even though it keeps attempting to collect). Bloem and Gorter (2001) have defined loans default as the loans left unpaid for a period of 3 months (90 days).

2.3. Loan Size

Loan size is the amount of loan approved by a financial institution for its borrower. It is argued that businesses with larger amount of loans are monitored closely by top management of financial institutions, and therefore are less likely to default in repayment because they are able to use the funds, ex post, for its intended purpose (Yohanna, Ahmed & Lawan, 2018). Conversely, smaller amount of loans to businesses may not be sufficient for successful implementation of the project, creating added uncertainties to its future cash flows (Derban, Binner & Mullineux, 2005; Benjamin, Paul & Haruna, 2017; Osman & Ramakrishna, 2017; Modisagae, & Ackermann, 2018). Therefore, the larger the loan size, the higher the repayment performance.

2.4. Loan Tenure

Loan tenure is the duration within which the loan is supposed to be paid off. It is the time that loan will last until it is fully paid off with regular payments. In other way round it is a period from the date of disbursement of loan to the last payment or closure of loan. Roslan and Karim (2009) have identified that loan tenure is negative and significant with loan repayment performance; demonstrating that shorter loan repayment period leads to higher loan repayment rate. Chelagat (2009) has also reported that longer loan repayment period caused lower loan repayment as borrowers were susceptible to default.

2.5. Interest Rate

Interest rate is the percentage of principle amount charged by the lender for its money (Ibrahim, Madawaki & Usman, 2014). It is also viewed as amount of interest due per period, as a proportion of the amount lent, deposited or borrowed. Therefore, interest rate is an important element in the demand and supply of loan and credit. Cassar, Crowley, and Wydick (2007) argue that borrowers who are able to repay their loans together with interest are those who are likely to be given preference in subsequent lending exercise. Higher interest rate, however, increases the cost of loan, and therefore deteriorates loan repayment performance (Afolabi, 2010).

2.6. Money Attitude of Barrowers

Attitude is a predisposition or a tendency to respond positively or negatively towards a certain idea, object, person, or situation. Attitude influences an individual's choice of action, and responses to challenges, incentives, and rewards (together called stimuli). Ziff (1971) also stated that individuals have certain attitudes that are basic and influence their behavior in many different types of situations. Therefore, individual people have certain attitudes that are basic and influence their behavior in many different types of situations. Studies like Nga and Yeoh, (2015) and Yamauchi and Templar, (1982) revealed that money attitudes influence financial behavior such as money spending and money saving. Several authors also research this area by exploring attitudes towards credit (Jill, Norvilitis & Mendes-Da-Silva, 2013; Khare, 2016).

2.7. Underpinning Theory

This study is guided by financial literacy theory. Financial literacy is the combination of consumers'/investors' understanding of financial products and concepts and their ability and confidence to appreciate financial risks and opportunities, to make informed choices, to know where to go for help, and take other effective actions to improve their financial status. Financial literacy helps in empowering and educating investors so that they are knowledgeable about finance in a way that is relevant to their business and enables them to use this knowledge to evaluate products and make informed decisions.

2.8. Empirical Review

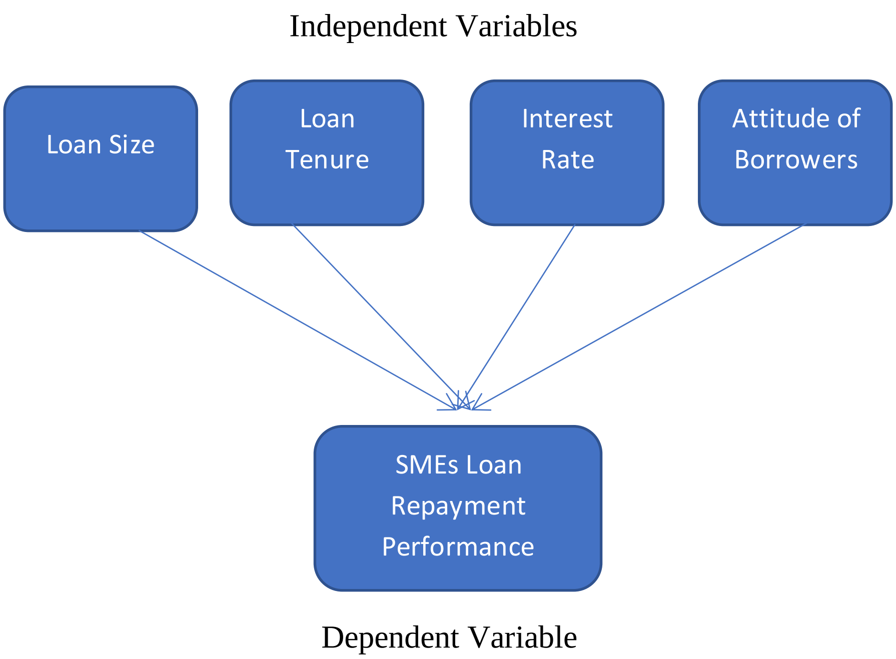
Ibrahim, Bambale, Aminu and Abdulwahab (2019) examine the mediating role of performance of small and medium enterprises on the relationship between loan characteristics and loan repayment in Kano metropolitan. Study establishes positive significant effect of loan size and loan tenure on loan repayment performance. Small and Medium Enterprises performance partially mediate the relationship between loan size, loan tenure and loan repayment performance. Mustafe, Willy and Muhammed (2019) studied factors affecting loan repayment performance of banks in Garowe district, Puntland, Somalia. Study revealed that period of loan and business purpose, education level, domestic purpose, availability of other source of income and social use have positive significant effects on loan repayment performance. But, business experience has negative significant effect on loan repayment performance, but loan size has positive insignificant effect on loan repayment performance.

Worokinasih and Potipiroon (2019) studied Microfinance Repayment Performance of SMEs in Indonesia. Results showed that social capital had a direct effect on SMEs' repayment performance, whereas favorable loan credit terms had an indirect effect on repayment performance through an improvement in business performance. Ahmad, (2018) examine the effect of money attitude dimensions on loan repayment among small and medium enterprises owner-manager in Kedah. The study confirms a significant effect of money attitude dimensions on loan repayment. Grace, Aguiyi, Theresa and Umebali (2018) examined loan repayment behavior among member of farmers` multipurpose cooperative societies in Anambra state, Nigeria. The result shows that educational qualification, farm size, loan application cost, and collateral value are influencing loan repayment performance significantly. While age, membership duration and income of the farmers are not significant to loan repayment performance. Modisagae and Ackermann (2018) examine the determinants of defaulting by collateral lending groups in micro financing: The study finding shows that probability of default decreases with larger groups, more female borrowers in a group and larger borrower savings. The results also indicate that probability of default increases with larger loan amounts and with borrowers who have more business experience. Tijani, Zakiya, Arifur Rahman and Mohammed (2018) examined the determinants of loan repayment performance of SMEs in Ghana. The study revealed that higher application data, loan size and interest rate put forth significantly negative influence on loan repayment performance. Ume, Ezeano, and Obiekwe (2018) examined the determinant factors of loan repayment performance among broiler farmers in Enugu state, Nigeria.. The study shows that household size, extension services, membership of organization, farming experience, educational level and off-farm income are influencing loan repayment positively, while high interest rate, low productivity, high collateral, poor loan assessment and changes in bank policy influence loan repayment negatively. Charls and Mori (2017) studied Loan repayment performance of clients of informal lending institutions in Tanzania. The result of the study revealed that multiple lending lead to poor loan repayment performance, while progressive lending leads to good repayment outcome. Enimu, Eyo and Ajah (2017) studied determinants of loan repayment among agricultural microcredit finance group members in Delta state, Nigeria. The analysis shows that group member's age, household size, house income, and educational level, the amount of credit received, length of stay in their locality, distance to the credit source, supervision and disbursement lag are major determinants of loan repayment. Osman and Ramakrishna (2017) examined the determinants of loan repayment performance in ACSI. The study shows that loan size and loan tenure is statistically significant with loan repayment performance. Ramanujam and Vidya (2017) studied the credit repayment behavior of borrowers in India. The study data were collected using structured questionnaire. Study revealed that borrower characteristics are not encouraging loan repayment performance.

2.9. Conceptual Model

This study adapted the following Model from the work of Roslan and Karim (2009) where predictors (loan size, loan tenure, interest rate and borrower`s attitudes of money) are the variables that can predict criterion variable (SMEs loan repayment performance). Therefore, the model can be depicted as;

Figure 1: Conceptual Model



3. Methodology

This study is a conceptual study, the existent related literature were reviewed to make a conclusion base on the findings of previous studies. Therefore, the method used in this study was desk review.

4. Conclusion

SMEs are some of the businesses in the world that cannot function/survive without an appropriate finance because of the nature of their operations and management style. However, there are so many credit facilities available for SMEs in Nigeria, which are meant to promote their activities. Majority of MFIs are giving loan to SMEs without collateral, which lead to delay as well as poor repayment performance. Therefore, this study discussed issues and concepts on loan size, loan tenure, interest rate, money attitudes of borrowers and loan repayment performance among SMEs. Based on the literature reviewed, there is significant relationship between predictors (loan size, loan tenure, Interest rate and borrower`s attitudes) and criterion variable (SMEs loan repayment performance). The study recommends that financial institutions should consider, loan size, loan tenure, Interest rate and borrower`s attitudes when giving loan to SMEs.

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