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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 loacted 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. However, lending rate revealed no significant greater risk for default rate. It was suggested that loan size should be based on certain percentage of a borrower's net income.

Key words: loan size, default rate, instalment size, repayment pattern, repayment period, instalment size, defaulted period, microfinance banks, lending rate, lending criteria

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 discriminate microfinance banks' from commercial banks' services are; (i) non-appearance 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 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 Credit and Savings Associations (ASCAs) and direct borrowings from friends and relations have always been provided by Nigerians among themselves before the advent of microfinance (Babajide, Taiwo, and Isibor 2015). 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 authorizing of microfinance banks in Nigeria (Akinjare, Babajide, Isibor, and Okafor, 2016).

The framework that would augment the provision of diverse microfinance services on a long-term justifiable basis for the deprived and low income groups, generate a podium for the founding of microfinance banks and increase Central Bank of Nigeria's governing/administrative performance in ensuring monetary steadiness and liquidity management (Taiwo, Agwu, Isibor, and Ikpefan, 2014) was the goal of the microfinance policy 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, existence of massive under-served market and need for enlarged savings opportunity (CBN, 2005).

Loan Default
A delinquent loan means a late payment (CGAP, 1999). A loan becomes delinquent before being defaulted which depicts 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 collateralized which can degenerate the credit portfolio. Since the inauguration of the microfinance policy framework in Nigeria in December, 2005, they have been threatened by copious encounters (Central Bank of Nigeria, 2005) as amended in 2011.

Loan default was well-defined by Adedapo (2007) as the borrower's incapability to justify his loan responsibility when payable. Henceforward, credit agencies attempt to avert loan delinquency and default because non-payment of loan leads to loss of capital to the lender which will make its banking operations no longer maintainable. The disappointment to meet the legal responsibilities (or conditions) of a loan is regarded as 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. Default is the financial impotency of a debtor to meet the lawful obligation of debt repayment. The powerlessness of a borrower to make his mandatory payment or a reluctance to honour his debt (Ledgerwood,2000); 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. There are three key categories of delinquency measures which are:
(i.) the amount collected which quantifies amount actually paid against amount that has fallen due;
(ii.) unpaid amount in arrears against whole amount of loan
(iii.) credit risk rate that measures the remaining loan balances that are unpaid as at when due alongside total loan balances outstanding (CGAP, 1999).
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). 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). A risk threshold pronounced by a point in the repayment history of a borrower to a loss of at least three instalments within a 12 month period which is signified by a point in time as an indicator of behaviour, wherein there is a noticeable increase in the risk that the borrower ultimately will default, by ceasing all repayment is called default according to the International Standards. This does not mean that the borrower has absolutely stopped paying the loan and therefore been referred to collection or lawful processes; or that the loan has been categorized as bad or doubtful, or actually written-off (Warue, 2012).

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 costs of loan delinquencies would be borne by the lender and borrower, 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 are 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 identified extraordinary lending rate by the microfinance banks as a reason for the dreadful default in 2009.

Idama et al (2014) commented that persistence of credit risk is a hazard to the survival of microfinance banks. An extensive variety of diverse and geographically dispersed institutions that offer financial services to low-income clients were non-governmental organizations (NGOs), non-bank financial institutions, cooperatives, rural banks, savings and postal financial institutions, microfinance banks (MFBs) and a growing number of deposit money banks (DMBs) embraced by microfinance banks (MFBs) in sub-Saharan Africa. A wide range of financial services like loans, savings, micro-insurance, micro-leasing, funds transfer, pension services, and so on are provided by microfinance banks to the underprivileged families. Microfinance banks have a growing acceptance of progressive influence by providing the underprivileged with microfinance services and facilities to create an encouraging socio-economic environment for many families in the emerging nations (Taiwo, Agwu, Babajide, Okafor, and Isibor, 2016). Microfinance banks have some distinguishable features from the traditional financial institutions like low capital requirements, insignificant scope and restricted services towards the deprived households as well as collateral- free group loans (Adu,2013).

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 up surged by declination in 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)

- unwarranted government interference with the operations of government sponsored credit programmes, loan deficiencies, loan delivery postponement, small farm size, extraordinary interest rate, 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 can be unpleasantly affected by loan pay-out interval, and 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
-It was instituted by Vandel in1993 that great lending rates by banks lead to loan default by borrowers
- Predominantly, non-performing loans occurred by 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 slowliness as specified by Nishimura et al (2001) are 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 loan application, difficult moral hazard and so on (Kohansal&Mansoori,2009)

In Kenya, it was established that failure of microfinance institutions and self-help groups' administration and management to proficiently manage certain reasons deliberated to be within the microfinance banks' direct control and Self Help Groups' (SHGs') triggered loan delinquency. Some exterior factors indirectly under the microfinance banks and Self Help Groups' supervision and control pay less to loan delinquency (Warue,2012). Consequently, operative administration of loan delinquency is dangerous for microfinance banks to comprehend, and pay attention on the internal reasons for loan delinquency which they have control over and pursue concrete and attainable solution to solve the challenges. This disruption knocks out typical financial markets and the repercussion lingers across the ball since the economic catastrophe which crushed microfinance banks and their clients. As the capital markets improved, apprehensions turned from funding to asset quality though the early stage of the recession made microfinance banks experience substantial liquidity deficiencies (CGAP, 1999).

Opposing macroeconomic blows together with 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 is a factor causing loan default, which would have alleviated risk of loss in case of default. In Uganda, scanty loan provision, illiteracy and in-sufficient 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)

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 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 lender makes 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 non-availability of collaterals which make some of them to 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.

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

- 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 deficiency in loan documentation, 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)

RESEARCH PROBLEM

The lending policy put in place by the management of some microfinance banks is meant to suit their purpose where loan size granted to individual client is not constructed on a certain percentage of their net income as done by deposit money banks which may end in poor repayment pattern and far ahead ends in loan default or make the repayment pattern of such customer staggered or incapable to repay most principally if such loans are not secured by tangible assets. Poor appraisal of customers before loan is granted will lead to loan default, as well as non-conformity to the lending canons stipulated by the microfinance bank's management.

METHOD

The study embraced a descriptive survey design to enrich wide-ranging analysis of the active variable estimated results: loan size and loan default. For this research, the survey research design was used. Stratified sampling technique was used to select sample from the target population. This technique is one of the most popular methods of sampling. There were one hundred seventy eight microfinance banks in Lagos State but twenty were selected for this study which is located in the state capital. The primary data obtained were analysed using linear regression through the administration of two hundred copies of questionnaire to microfinance banks borrowers where one hundred eighty two were returned.

SOURCE OF DATA COLLECTION

Well- structured questionnaires were used which encompassed two parts, part A and B. Part A covered respondents' demographic data while Part B contained instruments for the measurement of the Dependent variables (Loan default rate and Loan size) and the Independent variable. The major construct of the questionnaire were two namely: Loan size which was measured on two attributes –lending rate and instalment size while loan default rate is another major construct.

Model 1

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

Table 1Cox regression Estimates for rate of Loan Default

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, 2017

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 the table above. The table shows the individual effects of loan amount, lending rate and instalmental payment on rate of default. Further evidence from the result shows that loan amount and instalment size plays a significant role 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 above result thus indicates unfavouarable survival rate for the micro finance clients. However, lending rate reveals no significant greater risk for default rate. This implies that the amont of loan could significantly result to incresases in risk assocaited with client 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, 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 amount and instalment amount on loan default. It was observed from the instalment size and loan amount 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 back large amount of loans with the

accumulated instalments over time compared with the person that has small amount of loan 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 effectd 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.

SUMMARY

It was discovered that high loan size, high instalment size can contribute to loan default by increasing credit risk; increase in lending rate, loan size and shorter repayment schedules increase hazard ratio as indicated in the study. It was also discovered that number of dependants has negative effect on loan default that is the larger the family size during the course of obtaining loan, the higher the likelihood of not being able to repay the loan.

CONCLUSION

Microfinance banks in Nigeria are confronted with many challenges in their extension of 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 may affect the survival of microfinance banks. 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 but it is noteworthy for banks to have Loan Supervision Team, Collection/ Recovery Team as strategies to mobilise loans being disbursed to borrowers.

RECOMMENDATIONS

-Loan size should be based on financial capability and 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

-Quality collaterals and their substitutes (stock hypothecation and insurance policy) should be considered to secure microfinance banks' loans

-The MFBs loan policy should be reviewed by restricting the loan repayment patterns to weekly and monthly basis in order 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 default rate

- Effective monitoring of loan utilization should be done by microfinance bank's follow-up team to avoid diversion of loan by the borrowers to curb default

-There should be continuous training of MFBs staff on Microfinance banking which differs from the commercial banking training

-The microfinance bank's staff should be made to attend conferences, seminars and workshops that will enhance their performance

-There should be a re-training of retired bank officials being employed by MFBs in Microfinance banking as an area of specialization

-Workshops should be organised for the MFBs staff, operators (owners) and clients which can serve as a forum through which the stakeholders can express issues bothering them to minimise loan default

- There should be a yearly event through which the well behaved MFBs staff (who has adhered strictly to rules and regulations on loan) can be rewarded and MFBs clients who have not defaulted during several times of obtaining loans can also be commended

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