Determinants of Loan Repayment of Microfinance Institutions in Southeast States of Nigeria


Abstract - The study analyzed the loan repayment performance, institutional factors, and factors affecting repayment rate of microfinance institutions (MFIs) in the South-east states of Nigeria. It was carried out in three states namely; Ebonyi, Enugu and Imo, out of the five southeast states. Using a cross-sectional data a multi-stage sampling technique was employed in selecting a total of 36 MFIs from the three states, that is, 12 MFIs per state. The three states were purposively selected based on the performance index of United Nations Development Programme in the selection of Microstart Projects, which made the final list in the Southeast states of Nigeria. For the sample size, four MFIs were chosen each from formal (commercial and development banks), semi-formal (NGO-MFIs and community banks (CBs) and informal (Rotating Savings and Credit Associations (ROSCAS), ‘Isusu’, etc.). Results from the study, affirmed that the formal segment was more organized, better equipped with higher quality and well motivated staff than the semi-formal and informal segments. The informal sector presented the best repayment picture of the three segments, followed by the semi-formal institutions. Outstanding among the determinants of loan repayment of microfinance institutions were outreach, shocks, training duration, loan size and credit officer’s experience. Therefore, special attention must be given to these factors in order to improve the MFIs loan repayment performance.

Keywords: Determinants of Loan Repayment, MFIs

1.0 INTRODUCTION

Microfinance Institutions (MFIs) are those institutions which provide micro-credit, savings, and other services to the productive poor, both in the urban and rural settings. In Nigeria, the MFIs are categorized into: formal, semi-formal and informal institutions [1].

The Formal institutions comprised such institutions as development finance institutions (e.g. Nigerian Agricultural, Co-operative and Rural Development Bank Ltd. (NACRDB now called Bank of Agriculture), Bank of Industry, and Commercial Banks. Over 70% of these institutions/banks are located in the urban areas. There are ample evidences, which suggest that Nigeria is grossly under banked. Peter [2] shows that there are about 2,193 bank branches in Nigeria (one branch to 60,000 persons). This situation falls short of expectation in comparison with the distribution of banks in other countries like United Kingdom (1:3,500 persons), United States of America (1,400 per person) and India (1:30,000 person) [3]. The Central Bank of Nigeria [4] noted that the formal financial system provides services to about 35% of the economically active population while the remaining 65% are excluded from access to financial services. With the on-going reform in the banking sector, the number of banks had been pruned to 9 from 25 after 2005 revocation exercise. According to the World Bank Report [5], the contributions of banks to the GDP in Nigeria are put at only 9% as against 250% and 300% per USA and Japan, respectively. This situation is grossly unsatisfactory.

It is worthy to note that the greater balance of the population not served by the formal sector is often served by the semi-financial and informal sector. The semi-formal institutions involved in this dispensation include; non-governmental organization microfinance institutions (NGO-MFIs) and the community banks (now transformed into Micro-finance banks (MFBs). The NGO-MFIs and MFBs are community development organizations involved in rural development [6]. They render both financial (credit) and non-financial services (e.g. Community development activities on health and training in vocations) to their members, mainly the rural poor, especially, women. The NGO-MFIs are legal entities and are mostly registered as not-for-profit companies limited by guarantee and as such are able to sue and be sued under their names. They have Board of Directors or Trustees. These Boards comprise either only the founders or elected delegates. Generally, these NGOs are grouped-based organizations under the Trusteeship of Act as the sole package or part of their charity and social programmes of poverty alleviation.

The informal micro-financial sector comprised essentially the self-help groups (SHGs), which include – rotating savings and credit associations (ROSCAs) locally referred to as “ISUSU” or “ETOTOS” (Igbos) “ESUSU” or Bam (Yoruba) or “ASUSU” (Hausas), unregistered co-operative societies, age grades, farm work groups, town unions and family or kith and kin associations. These groups,
among others, have had developmental impacts in the rural areas. They are also group-based and essentially extend loan facilities to their members without physical collaterals but social securities or guarantors.

In terms of services, the commercial banks had several products, prominent among which were loans to agriculture and small scale industries. The NACRDB had facilities for agriculture and non-agricultural projects. Its target populations were both men and women. The NGOs targeted mainly poor women with limited income in trading, farming, agro-processing and tailoring while the semi-formal and informal groups accommodated both men and women with wide range of economic activities. Generally, the formal and community banks have both financial and non-financial products such as exports, issuance of letter of credits, preparation of studies and advisory services. The NGOs have in addition to financial products, human development programmes in education, health and provision of rural infrastructures.

A critical problem which cuts across most financial institutions is the issue of poor loan repayment. This has negatively impacted the ability of farmers to obtain capital to procure improved implements and technology as well as improved production inputs at affordable prices and at the right time and place [7]. Several agencies and credit institutions had been set-up by the government to assist these farmers or the productive poor. Such institutions include; family Economic Advancement Programme (FEAP), Peoples Bank of Nigeria (PBN) and the Nigerian Agricultural and Co-operative Bank Limited (NACB), all transformed into the Nigerian Agricultural Co-operative and Rural Development Bank, (NACRDB, now called Bank of Agriculture), Community Banks (CBs) now transformed into unit commercial banks/ microfinance banks; Agricultural Credit Guarantee Scheme Fund (ACGSF), Special Emergency Loan Scheme (SEALS), to mention but a few. Among the factors constraining the success of these credit institutions is poor loan repayment [8]. Reports from some of these institutions have revealed poor loan repayment positions over time. For example, [9] reported a repayment rate of only 1.05% of total loan granted for the small holder Direct Rural Loan scheme in Imo State. Food and Agricultural Organization attributed the inability of small scale farmers in developing countries to repay loans to the imperfections of the credit delivery system, a host of institutional factors and to the farmers themselves. The reasons for this inability included; unsuitable technology, poor selling prices, unsuitable disbursement procedures, inflexible repayment arrangement, inadequate supervision and quality of supervisory staff, natural disasters (e.g. erosion, pest and disease), diversion of fund and misconception of agricultural loans as part of national cake.

On the other hand, there are indications that loans obtained by rural farmers from the semi-formal and informal institutions exhibited impressive repayment rate with default rate of less than 5% [10].

These scenarios posed a big challenge for researchers, finance practitioners and consultants in the quest for not only operational self sufficiency but also financial self sufficiency for the agricultural credit schemes and programmes.

The question now is why are the repayment rates of informal and semi-formal financial institutions relatively higher than formal institutions, whose repayment rates are considered abysmally low? This study is aimed at providing the answer to this question.

It is reasonable to expect that an impressive loan repayment rate would be mutually beneficial to both the farmers/micro-entrepreneurs and loan institutions. On the part of the farmers good credit ratings would definitely attract more loans with which to procure improved inputs and technology. In such situation, efficiency will improve as well as profitability and these are capable of lifting them out of the vicious circle of poverty. For the financial institutions, which depend mainly on interest income for their institutional growth, prompt loan repayment would mean enhanced profitability and robust growth.

This paper, therefore aims at analyzing the loan repayment performance of MFIs in the Southeastern States of Nigeria, investigate their institutional factors and isolate factors which determine loan repayment.

2.0 MATERIALS AND METHODS

The study was carried out in the southeast geopolitical zone of Nigeria. The area is made up of five states out of 36 states of the Federal Republic of Nigeria. The five Eastern states were; Abia, Anambra, Ebonyi, Enugu and Imo. The area was purposively selected because of intense activities of self-help groups and is among the most densely settled area of the country with an average population density of 247 persons per square kilometer and a total population of 16.362 million which is about 42% of the country’s population [11].

Using a cross-sectional study design, a multi-stage random sampling method was employed in the selection of the study institutions. The sample frame was provided by the Central Bank of Nigeria (CBN) from the list of formal, semi-formal and formal institutions. In Stage One, three out of the five southeast states were purposively selected considering the states whose microfinance institutions were able to make the final assessment list in the selection of UNDP Microstart Project Nigeria. The states in the southeast which made the final list on the basis of SWOT analysis were Ebonyi, Enugu and Imo, and were therefore chosen. Stage two, involved the selection of MFIs, which are stratified into formal, semi-formal and informal. From each stratum, four institutions were selected randomly. Thus, giving a total of 12 MFIs per state and 36 MFIs for the there states selected. Two executive members of each institution were interviewed.

Finally, from each of the 12MFIs in a state, four respondents were selected randomly. This, gave a total of 48 respondents per state and 144 respondents for the three states representing the Southeast states. The respondents were selected from 28 out of 57 Local Government Areas in three states, and this represented about 49% coverage of the total number of the LGAs. The 28 LGAs came into the sample by chance factor as no deliberate effort was made to choose them.

Data collected were both primary and secondary. Secondary data were collected from periodicals, journals, textbooks, annual accounts of banks, and materials from UNDP, World Bank – CGAP (the Consultative Group to
Assist the Poorest) and their websites. Primary data were collected using structured, pre-tested questionnaire for the institutions. The collection of field data lasted for a period of nine months, effective April, 2005.

The data collected were analyzed using both descriptive and multiple regression analysis. The Ordinary Least Square (OLS) method of regression was used in estimating the relationship between loan repayment and the explanatory variables. The multiple linear form was adjudged the most appropriate for the financial function and consequently was chosen. The multiple linear form can implicitly be expressed as follows:

\[ Y_i = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \cdots + \beta_n X_n + e \]

\[ Y_2 = \text{Repayment rate of Institutions (mean % age of amount repaid by clients)} \]

\[ X_1 = \text{Outreach index (No of participants-product of Av Gp. Size and Av No. of Gps.)} \]

\[ X_2 = \text{Shocks (No of emergencies-crop/income losses, social events, etc in the last 18 months).} \]

\[ X_3 = \text{Gender dominance factor (proportion of female in the MFIs/Scheme in %)} \]

\[ X_4 = \text{Age of Operation (years)} \]

\[ X_5 = \text{Methodology (Scoring as stated in NB*)} \]

\[ X_6 = \text{Interest Rate (%)} \]

\[ X_7 = \text{Training Period (No. of Days)} \]

\[ X_8 = \text{Loan Size (N)} \]

\[ X_9 = \text{Credit Officer’s Experience (No. of Years)} \]

e = \text{error term}

**NB**: Enhanced methods or operational techniques were scored a maximum of 7 points using the following scoring criteria (Likert Scale):

- **Flexibility** – ability of the method to accommodate the need of members or introduction of new products (1 point).
- **Savings Mobilization** – ability of the method to stimulate confidence of members and thus encourage voluntary savings, which would enhance sustainability (2 points).
- **Outreach** – the ability of the methods employed to reach the target audience both in terms of number and depth of poverty (3 points).
- **Training Programme** – ability of the method to accommodate and encourage training programmes and extension services to members before disbursement (4 points).
- **Network/Linkage** – ability to share information and establish links with fund surplus units such as banks and bigger financial institutions for on lending to members (5 points).
- **Group formation content (Exogenous)** - where members form the group by screening, selecting, monitoring and even enforcing repayment where necessary, under the supervision of an NGO or outside agent (6 points).

- **Group formation content (Endogenous)** – where members themselves form the group by screening, selecting, monitoring and even enforcing repayment where necessary, without the intervention of outside agents (7 points).

**SWOT Analysis**: This analysis x-rayed the strengths, weaknesses, opportunities and threats of the MFIs and featured extensively in the discussion.

### 3.0 RESULTS AND DISCUSSION

#### 3.1 Institutional Factors

The institutional factors cover; legal structure and history, branch structures and geographical locations of MFIs, ownership/control/funding, leadership, human resource management, management information system, audit, and goals and objectives of the institutions.

Table 1 is the distribution of MFIs by types of organization/legal structure. It showed that there were 12 formal sector institutions (commercial banks and DFIs), 12 semi-formal (and NGO-MFIs) and 12 informal sector institutions (co-operatives, ROSCAS and “Esusu”). Thus, giving a total of 36 institutions. The mean age of the institutions was 6.6 years and 28% of them above 18 years.

The formal institutions (commercial and development banks) are by law authorized to accept deposits and grant credit facilities among other duties. The oldest among them was First Bank Plc. founded in 1984. The semi-formal institutions include CBs (MFBs) which like commercial banks are allowed to accept deposits and grant credits. However, the NGOL-MFIs which belongs to this group are not legally permitted to accept deposits (even though they do) but maintained capital build up funds (CBU), a mix of compulsory and voluntary savings from its members. They are essentially non-profit making organizations and they include the registered and unregistered CDAs, co-operatives and ROSCAS. They collected contributions and savings and extended credit to their members. They are age long associations and their legal identities as regards their duties were fragile or at best loose.

Table 2 is the distribution of institutions by branches and geographical locations. It showed that 50% of the 82 branches/organizations were located in the rural areas. This is not proportionate given that over 70% of our productive poor live in the rural areas. The formal institutions were major culprit in this dispensation.

Ownership, control and funding are most robust in the formal sector. The Annual General Meeting (AGM) is the owner and highest decision making unit. The Board of Directors report to this body. These two bodies provide the funding of this sector while the government through the Federal Ministry of Finance provides funding for the NACRDB Limited. The MFIs had similar structure with the AGM/Board enunciating policies and providing funds.
Table 1 Distribution of Institutions by Branches and Locations in the Study Area.

<table>
<thead>
<tr>
<th>MFI TYPE</th>
<th>BRANCHES</th>
<th>LOCATION</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>URBAN</td>
<td>RURAL</td>
</tr>
</tbody>
</table>
*Formal     | 3        | 3 0      |
NACRDB      | 22       | 9 13     |
First Bank Plc. | 19    | 12 7     |
Union Bank Plc. | 11     | 6 5      |
Afribank Plc |          |          |
* Semi-formal |         |          |
Osina CB    | 1        | - 1      |
Nnabuife CB | 1        | 1 -     |
Ndigbo CB   | 1        | 1 -     |
Nsline H/O  | 1        | 1 -     |
Nushe Branches | 3     | - 3      |
Other 8 NGO-MFI (Av. No of Branches = 1) | 8 | 8 - |
* Informal  | 12       | - 12     |
Non branches MFI |         |          |
Total       | 82       | 41 41    |
% age       | 100      | 50 50    |
Source: field data, 2005

Table 2 : Distribution of MFIs by Types of Organization /Legal Structure

<table>
<thead>
<tr>
<th>Class</th>
<th>Frequency</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>NGO</td>
<td>9</td>
<td>25</td>
</tr>
<tr>
<td>Commercial Banks</td>
<td>9</td>
<td>25</td>
</tr>
<tr>
<td>DFI (NACRDB)</td>
<td>3</td>
<td>8</td>
</tr>
<tr>
<td>Co-operatives</td>
<td>6</td>
<td>16</td>
</tr>
<tr>
<td>Community Banks (CBs)</td>
<td>3</td>
<td>8</td>
</tr>
<tr>
<td>ROSCAS</td>
<td>6</td>
<td>16</td>
</tr>
<tr>
<td>Total</td>
<td>36</td>
<td>100</td>
</tr>
</tbody>
</table>
Source: field data, 2005.

They also receive substantial grants and other financial assistance from both local and their foreign partners, especially faith based organizations. The informal sector did not have AGM and BOD rather they had 3 to 5 members of executives, who often times were not educated but piloted the affairs of the groups.

The leadership of the MFIs rested in the board and the management. For the formal MFIs, the quality of leadership was visionary, knowledgeable, robust and dynamic. For the semi-formal, the leadership was moderate in terms of goal achievement but slightly conservative and slow in information process. In the informal segment, leadership was constrained by knowledge, conservatism and lack of vision but was robust in commitment and trust.

In the other remaining institutional factors, the formal sector was more organized than the others. The human resources management had organizational structure that allowed for strict supervision, clear channel of reporting in order to achieve targets and discipline, and they are sometimes characterized as top heavy. Their internal control system had better standard checks against misappropriations. The internal control measures put in place in terms of cash movement and management were adequate and documented. They also had both internal and external auditors unlike most semi-formal sector. The informal did not enjoy these facilities. Profit motivation is the driving force of the commercial banks while developmental concerns were the prime objectives of the DFIs and the later were similar to those of NGO-MFIs, which emphasized economic and social empowerment of the productive poor. Some of these are reflected in their vision and mission statements. The informal segment had no documented mission statement but their names were philosophical, reflecting the mission and objectives of the association.

3.2 Loan Repayment Rates and Delinquency

(a) Segment: The overall repayment rates were 56.58%, 84.91% and 100% for the formal, semi-formal and informal institutions, respectively. This gave an average of 80.46% repayment for the MFIs.

Differences in repayment rates by various segments of the MFIs were analyzed using the ANOVA, Table 3. It showed that the F-ratio was 9.0365. Since F-cal was greater than F-tab at 5% level. This suggested that there existed differences in the repayment rates of the three segments of the MFIs and the differences were not due to chance factor.

Table 3: ANOVA for Differences in Repayment Rates by the various segments of the MFIs

<table>
<thead>
<tr>
<th>Source</th>
<th>SS</th>
<th>DF</th>
<th>MS</th>
<th>F</th>
<th>Significance f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Between Groups</td>
<td>650920</td>
<td>2</td>
<td>25460</td>
<td>9.0365*</td>
<td>0.013</td>
</tr>
<tr>
<td>Within Group</td>
<td>9705360</td>
<td>33</td>
<td>2941029.09</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>97704880</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Level of significance (LOS) = *5%
Source: Field data, 2005

(b) Determinants of Loan Repayment of the MFIs

Five out of 10 factors used that significantly affected repayment rates of MFIs were; outreach, shocks, training duration, loan size and credit officers experience.

(i) Outreach

This is the number of participants in the MFIs programme within the period of the study. The coefficient of the variable was positive and significant, suggesting that the greater the number of people covered, the greater the repayment rate. This appears theoretical and runs counter to the hypothesis which stated an inverse relationship, i.e. the smaller the number of clients, the higher the repayment rate.
Each variable interacted with loan repayment rate ($Y_2$). The 5 variables were chosen because their t-ratios (computed) were higher than t-tabulated.

Source: Computer printout, 2005

If MFIs cover larger clientele base in terms of number and geographic coverage without a proportionate increase in manpower and logistic facilities, inefficiency is likely to creep-in with respect to both coordination and performance. Repayment rate will surely slide down under such circumstances.

(ii) **Shocks**
These involved different types of family emergencies, crop income/losses, major social events, etc in the short term as reported by respondents. The coefficient was negatively signed in the hypothesis and the result strongly supported this view -- point and in addition, was significant at the 5% level. In other words, as number of shocks increased, default of respondents also increased. This will affect the asset quality of the MFIs. Information on shocks was asymmetrical especially in terms of quantum. Therefore, care must be taken in its interpretations.

(iii) **Training Duration**
This is the average number of days per year, which the MFIs used in training their staff. The formal sector spent an average of 15 days per credit officer while the semi-formal spent four days. However, the regression results did not substantially support the results, in practical terms as NGOs with less training period and informal sectors (without training programme) performed better, in terms of loan repayment than the formal sector. This does not suggest that training duration is not important in enhancing efficiency of credit officer, rather the issue borders on the effectiveness and quality of the training by the banks and the informal hands on training by the NGOs. The former seems to be more effective and also in agreement with [12].

(iv) **Loan Size**
Loan size like interest rate, was hypothesized to have a negative relationship with repayment rate. In other words, the higher the loan size given by the institution the lower was the repayment rate of the clients. The regression result strongly disagreed with this hypothesis. It stipulated that the higher the size of the loan to clients the higher the repayment rate. This situation appears to be most unlikely because the amount to be repaid was relatively larger and if the loan was from development oriented institution with subsidized interest rate and little chance of repeat loans, the pressure or inclination of such clients would be to delay repayment. It would be recalled that only 27.8% of respondents had benefited from repeat loans thus reinforcing this argument. However, a potent argument in favour of the result is that higher loans make possible larger investments with potentially higher absolute returns. This is in agreement with [13], [14].

(v) **Credit Officers’ Experience**
The regression result agreed strongly with the hypothesis which stipulated that credit officers’ experience had direct relationship with repayment rate. In other words, the higher the experience of credit officer, the higher the possibility of recovering greater amount of loan. This is true because an experienced credit officer knows when, how and where to put pressure on clients to effect payments. In addition, he/she might have become acquainted with clients over the years. This implied that MFIs require a good number of experienced Credit Officers in their Services.

The Linear equation can generally be represented thus:

$$Y_2 = \text{15.9317} + \text{10.1128}X_1 - \text{7.5912}X_2 + \text{6.4871}X_3 + \text{9.4429}X_4$$

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Table 4: Determinants of Loan Repayment by Micro Finance Institutions ($Y_2$):

<table>
<thead>
<tr>
<th>Variable</th>
<th>Unit</th>
<th>Coefficient</th>
<th>T-ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outreach</td>
<td>Number</td>
<td>10.1128</td>
<td>3.3033*</td>
</tr>
<tr>
<td>Shocks</td>
<td>Ranking</td>
<td>-7.5912</td>
<td>-3.3750*</td>
</tr>
<tr>
<td>Gender</td>
<td>Percent</td>
<td>6.4871</td>
<td>1.2002</td>
</tr>
<tr>
<td>Age</td>
<td>Years</td>
<td>9.4429</td>
<td>1.0589</td>
</tr>
<tr>
<td>Methods</td>
<td>Ranking</td>
<td>6.8175</td>
<td>1.1504</td>
</tr>
<tr>
<td>Interest rate</td>
<td>Percent</td>
<td>-10.2147</td>
<td>-1.1206</td>
</tr>
<tr>
<td>Training</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Duration</td>
<td>Days</td>
<td>9.8218</td>
<td>3.1041*</td>
</tr>
<tr>
<td>Loan size</td>
<td>Naira</td>
<td>11.1468</td>
<td>3.6799*</td>
</tr>
<tr>
<td>Experience</td>
<td>Years</td>
<td>7.9412</td>
<td>2.8213*</td>
</tr>
<tr>
<td>Constant</td>
<td></td>
<td>15.9317</td>
<td></td>
</tr>
<tr>
<td>R²</td>
<td></td>
<td>0.5200</td>
<td></td>
</tr>
<tr>
<td>F-value</td>
<td></td>
<td>3.8687</td>
<td></td>
</tr>
<tr>
<td>Error</td>
<td></td>
<td>2.8714</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td></td>
<td>36</td>
<td></td>
</tr>
<tr>
<td>d.f</td>
<td></td>
<td>26</td>
<td></td>
</tr>
</tbody>
</table>

LOS = *5%
tasks better than the banks and therefore achieved higher repayment rates. This was as a result of the advantages of collective action in screening of loan applications and monitoring of borrowers. The incentives for screening and monitoring the agents, actions of peers arose from joint liabilities and the potential loss of access of future loans. The main argument was that, compared with socially and physically bank agent, group members could obtain information, at the lowest cost, on the reputation, indebtedness, and wealth of loan applicants and about their efforts to ensure the repayment of the loan. Further, groups also had a comparative advantage in the enforcement of loan repayment from delinquent borrowers, group members had the potential to employ social sanctions or seize physical collaterals. In many rural areas, commercial bank agents had little leverage to go to a village and seize a defaulter’s collateral. Furthermore, group members appeared to be in better position to access the reasons for default and to perhaps offer insurance services to those members experiencing shocks beyond their control, while imposing sanctions on willful defaulters.

In terms of loan administration, the study highlighted the importance of paying special attention to outreach, shock, training, loan size and C.O. experience, which constituted the determinants of loan repayment rate in the study area at the period of the research.

4.0 CONCLUSION

It is apparent from the study that the NGO-MFIs were relatively new entrants in the terrain as compared to the commercial banks and the informal sector (e.g. Isusu and ROSCAS). The formal sector was most organized and their institutional goals were profit driven, but developmental for NACRDB. Similarly, the goals of NGO-MFIs and the informal sector were people oriented and welfare in content. Generally, the morale of staff in the formal sector was higher because they were better remunerated and equipped than the NGO-MFIs. The implication is that many employer of NGO-MFIs were using the organizations as springboard for greener pasture or further studies, and this explained the high staff-turnover recorded in that sector. In terms of loan administration of MFIs, outreach, shocks, training duration, loan size and credit officer’s experience should receive adequate attention.

REFERENCES
