Chapter 19
Factors Affecting Loan Repayment Performance of Microfinance Institution Borrowers:
The Case of Omo Microfinance at Wondo Genet Woreda, Ethiopia

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ABSTRACT

This study investigated the factors that affect the loan repayment performance of Omo Microfinance Institution borrowers at Wondo Genet Woreda, Ethiopia. Both primary and secondary data were used in the study. The required data were collected from 225 borrowers of Omo Microfinance. Respondents were selected by a stratified random sampling technique. Both qualitative and quantitative methods of analysis were used. The findings of the study revealed that 44.9% of borrowers in the study area did not repay the amount of money they borrowed as per credit schedules. The major factors that affect the loan repayment performance of borrowers were their sex, educational level, family size, borrowing experience, timelines of loan, repayment period and advisory visit.

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INTRODUCTION

Microfinance is the key strategy in alleviating poverty in developing countries. Microfinance Institutions (MFIs) are institutions that provide small loans to low income people either individually or as a group. Under the individual lending methodology, loans are granted directly to individuals or business entities. The effective repayment history of the individual normally determines accessibility to future larger loans. The group lending methodology involves providing loans to individuals within a group. The group members co-guarantee one another for repayment of the loan to the MFIs, and so providing a form of social collateral. In case of one member defaulting, the whole group is liable for repayment of the outstanding loan balance, otherwise they lose future access to loans (Candice, 2000).

The majority of microfinance institutions provide collateral-free small loans to low income households. These loans are generally expected to be used for self-employment and income regenerating activities (Kono and Takahashi, 2010). Microfinance can be a critical element of an effective poverty reduction strategy. Well organized access and efficient provision of saving, credit and insurance facilities in particular can enable the poor to smooth their consumption, manage their risks better, build their assets gradually, develop their microenterprise, and enhance their income earning capacity. Thus, microfinance helps to promote economic growth and development (Fernando, 2006).

In developing countries, including Ethiopia, microfinancing institutions (MFIs) emerged with unique opportunity to serve poor people who do not have access to commercial banks. Microfinance is relatively new to Ethiopia and came to existence during 1994-1995 with the government's licensing and supervision of microfinance institution proclamation to deliver micro-loans, micro-savings, micro-insurance, money transfer, leasing, etc. to a large number of productive resource-poor people in the country in a cost-effective and sustainable way (Sileshi et al., 2012).

However, the performances of micro-finance institutions are challenged mainly by the failure of the borrowers to repay the loan. The loan repayment performance of the borrowers depends on the effectiveness of their small business in urban areas, and the productivity of their crops in rural areas. Moreover, the fluctuations of product prices, which are difficult to predict, also affect the loan repayment performance of borrowers thereby microfinance institutions (Wolday, 2000). Currently, most of the microfinance institutions suffer from credit risk, which leads to default.

In Ethiopia there are studies conducted in Addis Ababa, Hawassa and Bahir Dar, Dire Dawa, Zeway, Northern Gonder, Harergie, Keffa, Kuyu and Dodota Woreda on the issue related to determinants of loan repayment in microfinance institutions, but most of them were focused on major cities and none of them used the combination of paired sample t-test, Chi-square and binary logistic regression which are used in this study to identify the major factors that affect loan repayment performance of both borrowers and lender institution.

Statement of the Problem

Microfinance institutions were established to fill the gap of scarce finance resources by providing funds to the poor and lower income group to alleviate poverty and enhance their engagement in business activities to generate their own income (Norhazia, 2010). However, Omo microfinance institution at Wondo Genet Woreda faced serious challenge that forced the institution not to achieve its set objective and goal since the number of defaulters are increasing from time to time.