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THE INFLUENCE OF BUSINESS SKILLS OF GROUP MEMBERS ON REPAYMENT OF GROUP LOANS AMONGST MICROFINANCE INSTITUTIONS IN NAKURU TOWN

Henry Bundi Ndege

University of Nairobi

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Abstract

The Microfinance Institutions (MFIs) play a critical role in financial inclusion leading to poverty eradication and economic empowerment of financially marginalized persons such as people of low economic status. In the provision of access to credit facilities to the financially marginalized persons, the MFIs often adopt the group lending policy with a view of mitigating credit risks in lending to their target customers. The majority of MFIs across the globe have adapted the use of joint liability in group lending as a means of enhancing loan performance. The business skills of group members have a critical influence on the repayment of the group loans in the context that most of the loans are meant for business activities. Since the small loans often acquired through group lending are used for business activities then any factor impacting on profitability of the businesses impacts on capacity to repay the loan. The lack of necessary knowledge and skills can therefore significantly impact on the group borrowers prudently utilizing funds allocated to them. This paper examines the influence of joint liability of group members on repayment of group loans amongst microfinance institutions in Nakuru town. This study seeks to determine the influence of business skills of group members on repayment of group loans amongst microfinance institutions in Nakuru town. The p value for one way ANOVA for business skills and loan repayment terms was 0.283 which was above 0.05 ($p=0.283> 0.05$). This lead to the acceptance of the null hypothesis that the business skills of group members have no statistical significant influence on repayment performance of group loans amongst microfinance institutions in Nakuru. The study found that the business skills of group members do not have a statistically significant influence on the loan repayment performance of group loans amongst microfinance institutions in Nakuru. It recommended that group members focus on delivering excellent customer service in their businesses order to ensure that customers are satisfied with the services and products offered.

Keywords: Business Skills, Group Loans, Loan Repayment Performance

I.Introduction

The Microfinance Institutions (MFIs) play a critical role in financial inclusion leading to poverty eradication and economic empowerment of financially marginalized persons such as people of low economic status (Addae-korankye, 2014). The financial inclusion refers to the methods of availing financial services at reasonable affordable prices to persons often at the bottom of the economic pyramid (Coker and Audu, 2015). These are people that the traditional and mainstream financial institutions are largely uninterested in investing in due to institutionalized and rigid structures, low returns and/or the modus operandi of financial service providers (Oruo, 2013). In the provision of access to credit facilities to the financially marginalized persons, the MFIs often adopt the group lending policy with a view of mitigating credit risks in lending to their target customers (Mokhtar, 2011).

According to Abafita (2003) group lending or group loans refers to loans issued by MFIs to groups under a joint liability method. The joint liability aspect refers to the collective assumption of responsibility for loan repayment performance of loans advanced to group members. The concept of joint liability enables the members to screen loan applicants, monitor individual borrower's efforts, and undertake enforcement measures amongst their members (Njangiru, 2014). This is because the failure of an individual member in meeting their loan repayment obligation is punitive to all the group members. The underlying principle of group loans is that the need for collaterals such as land, log books and pay slips that are often used to minimize credit risk in traditional financial institutions is replaced by social collateral. It is the unavailability of the collaterals that often leads to financial exclusion of the people of low income status.

There are several advantages associated with group lending. In the context of advantages, the group members performs roles that would traditionally be performed by the MFIs in relations to loans of individual members such as screening of potential borrowers, and enforcement of repayment terms amongst members (Were, 2013). These functions reduce the credit risk associated with individual borrowers as the group members are able to utilize information on members that wouldn't be at the disposal of the MFIs (Sileshi, Nyikal, and Wangia, 2012). This information includes the levels of indebtedness, information relating to reputation of the members, and information on wealth of the borrower amongst other useful information. This enables the members to monitor loan disbursement and repayment in a more efficient ways than the MFIs. For example, members who are heavily indebted and multiple loan defaulters may find themselves being denied opportunity for further credit access. The group members are also often in a better position from a logistical dimensions in enforcing loan recovery options such as seizing the members' properties due to ease of access amongst other aspects (Weber and Musshoff, 2012).

The business skills have a critical influence on the repayment of the group loans in the context that most of the loans are meant for business activities (Angaine and Waari, 2014). Since the small loans often acquired through group lending are used for business activities then any factor impacting on profitability of the businesses impacts on capacity to repay the loan (Nawai and Shariff, 2012). In this context, Muli (2016) indicates that the lack of necessary knowledge and skills significantly impacted on the group borrowers prudently utilizing funds allocate to them. This leads to poor business performance leading to diminishing of capacity to repay the loans. The capacity to pay is a critical component of the 5Cs of the credit worthiness appraisal system and which determines loan repayment performance. The other aspects include Character, Capacity, Capital, Collateral and Conditions.

II.Research Objective

To determine the influence of business skills of group members on repayment of group loans amongst microfinance institutions in Nakuru town.

III.Research Question

How do business skills of group members determine repayment of group loans amongst microfinance institutions in Nakuru town?

IV.Research Hypothesis

H_{01}: The business skills of group members have no statistical significant influence on repayment performance of group loans amongst microfinance institutions in Nakuru.

V. Literature Review

Moral Hazard Theory

The moral hazard theory is based on the notion that one of the parties in a transaction such as loan transaction has not entered the contract in good faith. In the context of the borrower, this can occur as a result of misleading information on the borrowers' capacity to pay and the securities held to mitigate the credit risk , that is, risk of defaulting (Akwanyi et al., 2013). The moral hazard may also occur as a result of the borrower utilizing the funds in a risky way that compromises his ability to repay the loan (Gebeyehu, Beshire, and Haji, 2013). The moral hazard theory assumes that the borrower has incentives to default on their loans unless there are consequences for such actions.

The moral hazard theory is applicable to the concept of loan performance within the context of group lending. Postelnicu et al., (2014) in a study on the social collateral in microfinance group lending notes that the importance of shared information amongst group members in mitigating moral hazard challenges. The study noted that borrowers within a group use shared information about each other to ensure that the borrowers use the loan for the promised income-generating purpose (that is. to mitigate ex-ante moral hazard problems), as well as to avoid strategic default (that is. to mitigate ex-post moral hazard). The groups must reduce the moral hazards amongst their members in order to enhance their social collateral that qualifies them for the loan qualification. In order to avoid losing social collateral, the group members must deter each other's moral hazard behaviour. Therefore, this theory was critical in the examination of the role of business skills of group members in the repayment performance of group loans in order to mitigate ex ante moral hazard problems and ex post moral hazard challenges respectively.

Business Skills and Repayment Performance

The cash flow management skills are critical in the success of the Micro, Small and Medium Enterprises (MSMEs) which is the main purpose of group loans. The cash flow management involves the monitoring cash levels which include hard cash and funds deposited at the bank account. According to Kabethi (2013), cash management is the cash balances and movements within the businesses. The cash flow management in any MSME is critical in ensuring that there is sufficient cash for running expenses while holding sufficient stock for trading purposes. The ability to hold the optimum cash levels without incurring a huge opportunity cost in terms of held stock is of critical importance.

The management skills are critical in the loan repayment performance within the context of group lending. The management skills refer to the ability of an individual to make decisions and lead subordinates within a group. The most common skills that exist within the larger management skills include social skills, technical skills and conceptual skills (Kabethi, 2013). The social skills refer to the ability to interact and motivate the group members while technical skills refer to the understanding of the concepts of group lending. There are diverse competencies associated management including communication, people skills, negotiation skills amongst others.

The management skills are critical in group lending. This is due to the fact that the money is either lent to the groups for the purposes of sub dividing to group members or issued directly to individuals within a group. Whichever of the two methods that are used to secure the loans, the loans is often granted under a joint liability method meaning that the members are jointly and individually responsible for repayment of the loan for any defaulting group members. The management of the group therefore is of fundamental importance to the loan repayment performance. Amongst the aspects critical in this examination include peer monitoring, peer screening, recovery of bad debts, and credit rationing of members (Nawai and Shariff, 2012).. The groups with better management aspects are well coordinated in their group functions that collectively form the social collateral that MFIs use for the purposes of group lending. The management is therefore critical in directing group dynamics that affect the loan repayment performance.

The record keeping aspect is a critical component of the success of the MSMEs across the world. The record keeping enables the optimum performance of the MSMEs through tracking the levels of critical aspects within a business including sales levels, key customers, stock levels and cash flow levels amongst other aspects. This information is important for the purposes of planning within the business hence improving the overall business viability. The MSMEs viability will then improve on the capacity to repay the group loans. On the other hand, the customer service skill is critical in ensuring that the MSMEs customers are satisfied with the services and products offered. Amongst the critical aspects of customer service for business survival include the customer on-boarding, customer loyalty, customer retention levels, complaints handling and customer relationship management.

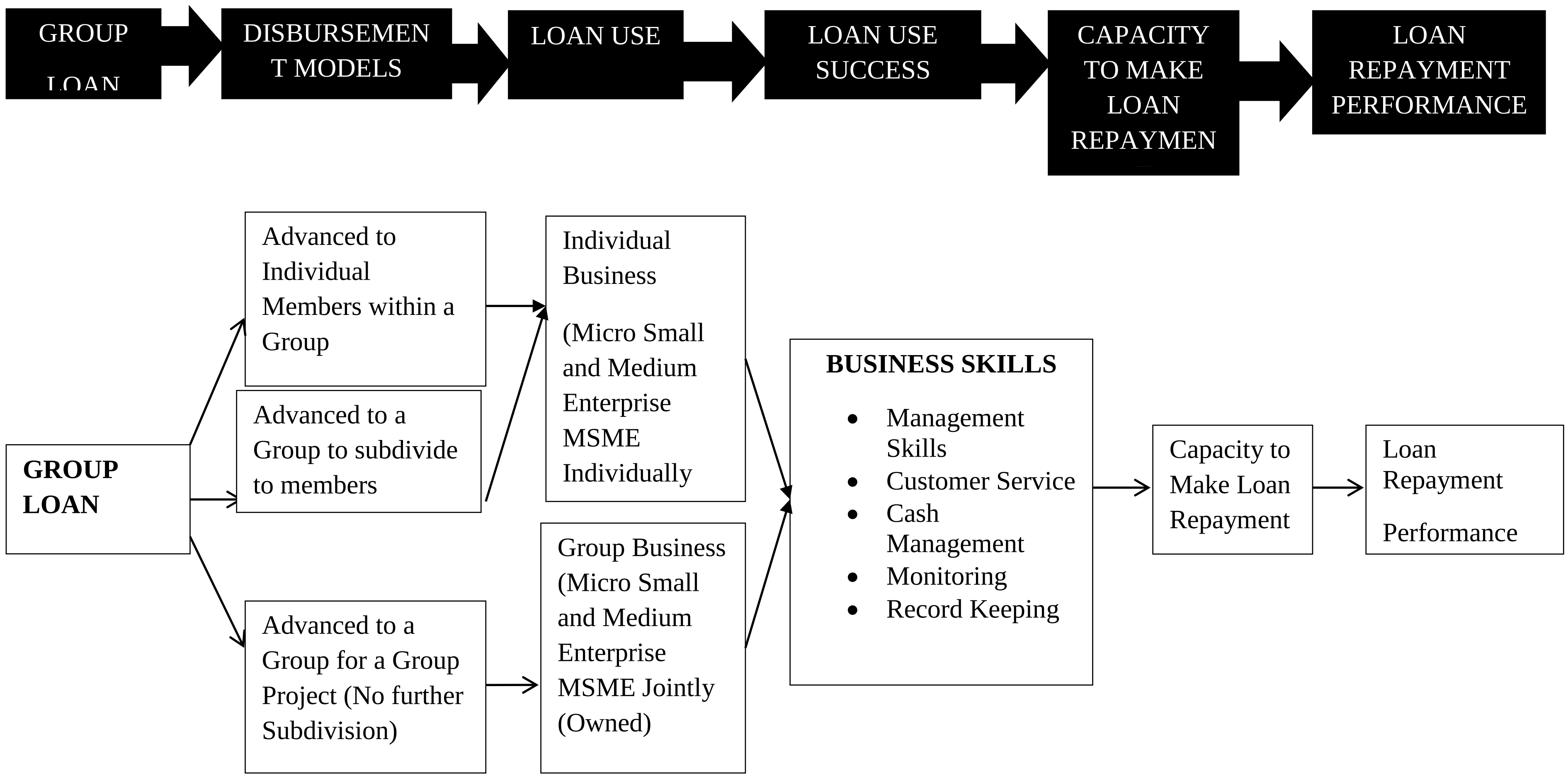

Figure 1: Influence of Business Skills on Loan Repayment Performance

VI.Research Methodology

This study employed a descriptive research design. This design was considered appropriate for the research as the researcher was interested in the influence of joint liability of group members on repayment of group loans amongst microfinance institutions. There was no manipulation of variables that was undertaken. The target population for this study comprised of all the 24 financially distressed commercial banks in Kenya that restructured their assets during the period 1992 -2016. The target population was 2,280 group members of the groups that had borrowed from MFIs within Nakuru town. The sample size was calculated using Naissuma's (2009) formula which resulted in 96 respondents. The 96 respondents were derived using the stratified random sampling method which ensured that the sample members were proportionally distributed across the MFIs. The study employed primary data extracted from structured questionnaires. The structured questionnaires were used since they allow easy analysis o u data using software such as SPSS as they derive quantitative data. They can be distributed to a large number of respondents due to their ease of administration as well as responding the set questions. A pilot study was undertaken amongst groups in MFIs in Gilgil using 10 respondents which constituted 10% of the sample size. It addressed issues including clarity of questions, presentation of the questions, validity and reliability of the questions. The pilot study was therefore undertaken. The content validity of the study was examined using the experts of MFIs which constituted the university based lecturers as well as industry practitioners. The reliability of the research instrument was examined using the internal consistency of the data and tested using Cronbach alpha coefficient of a threshold of 0.7 and above. The data analysis was undertaken using SPSS version 21**.** The descriptive statistics that were utilized include frequency distributions, means, and standard deviations. The hypothesis testing was undertaken using the one way ANOVA.

VII.Research Findings and Discussions

Descriptive Statistics

The study sought to know which business skills of group members affect repayment of group loans. In examining this, the metrics used included record keeping in a business, cash flow management in a business, management skills in a business, monitoring and evaluation in a business, and customer service in a business. In the context of record keeping in a business, most of the respondents (55.0%) strongly agreed record keeping affects repayment with an additional 33.8% who agreed affirming the same. The uncertain, disagreed and strongly disagreed responses attracted 6.3%, 3.8%, and 1.3% of the respondents respectively as dislayed in Table 1.

Table 1: Frequency Distribution of Business Skills

	SA %	A %	U %	D %	SD %
Record Keeping in a business	44 55.0%	27 33.8%	5 6.3%	3 3.8%	1 1.3%
Cash flow management in a business	36 45.0%	27 33.8%	14 17.5%	3 3.8%	0 0.0%
Management Skills in a business	34 42.5%	38 47.5%	5 6.3%	3 3.8%	0 0.0%
Monitoring and Evaluation in a business	33 41.3%	39 48.8%	6 7.5%	1 1.3%	1 1.3%
Customer Service in a business	54 67.5%	22 27.5%	4 5.0%	0 0.0%	0 0.0%

In respect to cash flow management, none of the respondents chose the strongly disagree prompt , 45.0% and 33.8% of the respondents chose the strongly agreed and agree prompts. Those who were unsure whether cash flow management in a business affects repaymentof group loans were 17.5% while those who disagreed were 3.8%. When asked whether management skills in a business affects repayment of group loans, a cumulative majority of 90.0% of the respondents were of the opinion that they do with 42.5% and 47.5% choosing the strongly agree and agree prompts, while 3.8% felt the management skills in a business do not affect repayment of group loans.

In the context of monitoring and evaluation in a business, an equal number of respondents (1.3%) chose disagree and strongly disagree prompts, while most of the respondents (48.8%) agreed and 41.3% strongly agreed that it does affect repayment performance of group loans. In the context of customer service, most of the respondents (67.5%) felt customer service in a business highly affects the affect repayment of group loans with an additional 27.5% in agreement on the same. This was further supported by there being no disagree and strongly disagree responses on the metric with only 5.0% uncertain.

The means in the study were grouped into five intervals indicating tendency to either strongly agree, agree, uncertain, disagree and strongly disagree, that is, strongly agreed ($4.5< \mu \leq 5$), agree ($3.5< \mu \leq 4.5$), uncertain ($2.5< \mu \leq 3.5$), disagree ($2.5< \mu \leq 1.5$), and strongly disagree ($1< \mu \leq 1.5$). In the context of the influence of business skills on repayment of group loans, on average the respondents tended to agree that they have an effect on loan repayment due to means of above 3.5 as shown in Table 2.

Table 2: Means and Standard Deviations of Business Skills

	Mean	**Std. Dev.**
Record Keeping in a business	4.38	0.86
Cash flow management in a business	4.20	0.86
Management Skills in a business	4.29	0.75
Monitoring and Evaluation in a business	4.28	0.76
Customer Service in a business	4.63	0.58

The means of record keeping, cash flow management, management skills, monitoring and evaluation, and customer service were 4.38, 4.20, 4.29, 4.28 and 4.63 respectively. Therefore, the respondents were on average in agreement with the business skills impacting on the loan repayment aspects of the group loans.

These results are in tandem with the reviewed literature and in findings of the studies by Angaine and Waari (2014), Nawai and Shariff (2012) and Muli (2016). Angaine and Waari (2014) indicated that business skills have a critical influence on the repayment of the group loans in the context that most of the loans are meant for business activities. This is attributable to the fact that the small loans acquired through group lending are used for business activities then any factor impacting on profitability of the businesses impacts on capacity to repay the loan (Nawai and Shariff, 2012). In the same note, Muli (2016) indicated that the lack of necessary knowledge and business skills significantly impacted on the group borrowers prudently utilizing funds allocate to them. This leads to poor business performance leading to diminishing of capacity to repay the loans. Therefore, the business skills influence the repayment of group loans through ensuring that the members who have borrowed funds have the capacity to repay the loans through an optimal business performance.

The standard deviations were grouped into three intervals indicating high consensus ($\sigma_X \leq 0.5$), moderate consensus ($0.5 < \sigma_X \leq 1$) and no consensus $\sigma_X > 1$. In the context of the influence of business skills on repayment of group loans, there was moderate consensus that they have an effect as the standard deviations of all the metrics on business skills were in the range of ($0.5 < \sigma_X \leq 1$). Customer service in a business scored the lowest standard deviation (0.58) among the business skills metrics. This implied that customer service in a business had the greatest consensus in the responses of business skills metrics due to a comparatively low standard deviation. Record keeping and cash flow management in a business had the highest standard deviations amongst the business skills metrics indicating a comparatively lower consensus amongst the respondents in response their influence on loan repayment performance. This is due to the fact that with a standard deviation score of 0.86 they had the highest standard deviations amongst the business skills metrics.

Hypothesis Testing

The hypothesis testing was undertaken using the fisher one way analysis of variance. The first step was the stating of both the null and alternative hypothesis that was to be tested for each of the objective. The test statistic was then selected. In this study, the one way ANOVA was used in hypothesis testing at 0.05 level of significance. The p value of the ANOVA table was then compared to the significance level to inform on whether to reject the null hypothesis. The null hypothesis was rejected if the p value was less than the 0.05 level of significance.

The p value for one way ANOVA for business skills and loan repayment terms was above 0.05 leading to the acceptance of the null hypothesis. In this context, the null hypothesis (**H_{01}**) that the business skills of group members have no statistical significant influence on repayment performance of group loans amongst microfinance institutions in Nakuru was accepted since $p=0.283 > 0.05$.

VIII.Conclusion of the Study

The study concluded that the business skills of group members do not have a statistically significant influence on the loan repayment performance of group loans amongst microfinance institutions in Nakuru.

IX.Recommendations OF THE STUDY

The study recommended that group members focus on delivering excellent customer service in their businesses in order to ensure that customers are satisfied with the services and products offered. This will ensure that the businesses survive and make sufficient returns which will improve the loan repayment performance.

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