BORROWER'S CHARACTERISTICS AND LOAN REPAYMENT PERFORMANCE AMONG SMALL AND MEDIUM ENTERPRISES IN MOGADISHU, SOMALIA

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ABSTRACT

Loan repayment among small and medium enterprises in Mogadishu has remained a challenge as demonstrated by the low recovery rates recorded by the available financial institutions like commercial banks and microfinance institutions in Somalia. This situation has contributed towards a reduction on profitability margins reported by these financial institutions. This study was set out to establish the effect of borrower's characteristics on loan repayment performance among small and medium enterprises in Mogadishu, Somalia. The information asymmetry theory provided anchorage to the study. Mixed research design covering descriptive survey design and correlational design was adopted targeting 45 credit officers from financial

institutions in Mogadishu Somalia and census was undertaken. Information was obtained from its primary form using questionnaire that had been determined for reliability and validity. The analysis of the findings was done through Statistical Package for Social Sciences utilizing means, standard deviations, correlation and regression analysis and tables supported the presentation of the results. It was observed that borrowers' characteristics significantly explain 70.8% variation in loan repayment performance among small and medium firms in Mogadishu, Somalia (R2=0.708, p<0.05). The study concludes that borrowers' characteristics are significant predictors of loan repayment performance among small and medium firms in Mogadishu, Somalia. The study recommends that credit officers working among financial institutions should critically and analytically appraise the borrower's characteristics like gender, age and level of income to qualify for loans. The borrowers among the financial institutions in Somalia should adhere to the principal of utmost good faith without concealing any specific characteristic that they have knowledge of.

INTRODUCTION

Loan repayment performance is so instrumental to both the borrowers and the lending financial institutions. Loan repayment performance arises when the borrower repays loan on time as specified in loan contract (Worokinasih & Potipiroon, 2019). Loan repayment performance measures if the borrowers repay their loans in full as specified in the contract. The higher the loan repayment performance, the greater the liquidity position of the lending institution and ability to meet debt obligation (Rafay, Farid, Yasser & Safdar, 2020). High loan repayment performance allow financial institutions to reduce interest rate it charge borrowers and thus lowering financial cost of accessing credit and this allow more borrowers to access funds. High loan repayment performance increases the adequacy of the lending institutions to meet the needs of the borrowers (Salifu, Tofik-Abu, Rahman & Sualihu, 2018).

Borrowers' characteristics are attributes that loan applicants need to demonstrate if they have to have access to loan facilities (Sun & Gao,

2019). Access to loans by borrowers is a function of the seriousness that lending institutions attach to borrowers' characteristics during the loan appraisal process. There are broad categories of borrowers' characteristics including marital status, education, gender, age as well as experience, assets the borrowers own as well as the ability to pay. As demonstrated by Adamou, Jude, Dieudonné and Abba (2020), effective operation of any credit scheme requires clear understanding of the borrowers as far as loan repayment is concerned.

There exists a dearth of empirical literature indicating that borrowers' characteristics are critical in influencing loan repayment performance of borrowers. Thayaparan and Sivatharshika (2019) observed that borrowers' characteristics like family members, income and age predicted loan repayment performance in Sri Lanka. Within the context of Uganda, Ssekiziyivu, Bananuka, Nabeta and Tumwebaze (2018) obtained contradictory evidence that borrowers' characteristics and loan repayment performance are not significantly connected with each other. However, evidence from Ethiopia by Jote (2018) indicates that business experience, sex and age are all critical borrowers' attributes that significantly predict the loan repayment performance. Similarly, Ogeisia, Musiega and Manase (2014) observed that borrowers' characteristics and loan repayment are strongly linked with each other.

Small and medium enterprises (SMEs) are firms characterized by a relatively smaller scope of operation and labor force. Because this limited scope of operation, these firms do not enjoy any economies of scale as compared to the relatively large and well established firms. These firms face a major hurdle in accessing funds from formal lending institutions like commercial banks because they are perceived to be too risky since they can easily default on their loans. Therefore, loan repayment performance of these SMEs is likely to be challenge occasioned by uncertainty and the unique personal attributes of owners of these firms who have borrowed funds from lending institutions.

Based on the available literature, it can be inferred that the nexus between borrowers' characteristics and loan repayment performance is mixed and inconsistent and require further empirical studies. While some evidence indicate existance of significant nexus between borrowers' characteristics and loan repayment performance (Jote, 2018), others indicate existance of an insignificant interplay (Ssekiziyivu, Bananuka, Nabeta & Tumwebaze, 2018). It is against this background that the present study sought to clear this contradictory evidence and thus a strong need to determine the effect of borrower's characteristics and loan repayment performance.

Research Problem

Loan repayment among SMEs in Mogadishu has remained a challenge as demonstrated by the low recovery rates recorded by the available financial institutions like commercial banks and microfinance institutions in Somalia. This situation has contributed towards a reduction on

profitability margins reported by these financial institutions. This trend in poor loan repayment among SMEs is an issue that requires urgent policy attention failure to which probable financial crisis is likely to occur and its persistence can lead to collapse of these institutions leading to loss in customer deposits. The available studies include Thayaparan and Sivatharshika (2019) who focused on Sri Lanka and not Somalia arguing that borrowers' characteristics significantly predict loan repayment performance. With a focus on Uganda and not Somalia, Ssekiziyivu et al. (2018) obtained contradictory evidence that borrowers' characteristic and loan repayment are not significantly connected with each other. The study by Jote (2018) focused on Ethiopia and not Somalia. Therefore, the existing studies create contextual and conceptual gaps that the present study sought to fill by analyzing the effect of borrower's characteristics on loan repayment performance among small and medium enterprises in Mogadishu, Somalia.

RESEARCH OBJECTIVE

The study sought to determine the effect of borrower's characteristics on loan repayment performance among small and medium enterprises in Mogadishu, Somalia.

RESEARCH HYPOTHESIS

H01: borrower's characteristics have no statistically significant effect on loan repayment performance among small and medium enterprises in Mogadishu, Somalia.

LITERATURE REVIEW

Theoretical Review

The study was guided by the information asymmetry theory by Akerlof (1970) which indicates that parties in any economic transaction should have full information and knowledge about each other so as to execute informed decisions. The theory is premised on the fact that tradable products in the market like loan products have attributes that each party to the transaction can easily view. The mismatch of information between borrowers and financial institutions can allow one party to benefit more from the transaction as opposed to the other party. In the case of this present study, borrowers may have some specific information regarding their characteristic like their level of income, level of education and age that the financial institution may not have. These attributes can then shape the loan repayment performance once funds have been disbursed to the borrowers from the financial institutions.

Empirical Review

Borrower's income is regarded as one of the key predictors of loan repayment performance. Generally, it is assumed that borrowers having low level of income are likely to default on their outstanding loan facilities with a lending institution (Thayaparan & Sivatharshika, 2019). On the other hand, borrower whose income is relatively higher and having bank

account are less likely to default on their loans. Higher income provides an indication that more resources are available for repayment of loan by the borrowers (Thayaparan & Sivatharshika, 2019).

Loan repayment performance can also be predicted by the level of education of the borrowers. Literature indicates that borrowers with high level of education are less likely to default (Njangiru, James & Muathe, 2014). Better education implies stable employment and the possibility of earning high amount of income that improve the loan repayment efforts of the borrowers (Ogeisia, Musiega & Manase, 2014).

The age of the borrower is an important predictor of loan repayment (Jote, 2018). The available evidence indicates that young (less than 30 years) and older (above 60 years) borrowers have less probability of defaulting on their loans and thus they have low risk of bankruptcy. High probability of default is associated with borrowers in their middle age (Thayaparan & Sivatharshika, 2019). Older borrowers are characterized by high level of maturity and business experience that are likely to drive the level of productivity and performance of their businesses thus likely to pay their loans on time.

CONCEPTUAL FRAMEWORK
Figure 1 is the conceptual framework that guided the study.
Figure 1: Conceptual Framework

RESEARCH METHODOLOGY
The study adopted mixed research design covering descriptive survey and correlational design. While descriptive survey allowed in covering all the financial institutions in Mogadishu, Somalia, correlation design helped in testing of the hypothesis. The study targeted 45 employees from credit departments of 6 commercial banks and 3 MFIs with operations in Mogadishu Somalia as shown in Table 1.

Table 1: Target population

Name of Financial Institution	Target Population
COMMERCIAL BANKS	
International Bank of Somalia	7
Premier Bank	6
Salaam Somali Bank	8
Dahabshiil Bank International	6
My Bank	4
Amal Bank	4
MICROFINANCE INSTITUTIONS	
Kaah International Microfinance Services KIMS	3
MicroDahab	4
Kaaba Microfinance	3
Total	45

Since the population is relatively small and could easily be accessed, census was undertaken and thus all the 45 respondents were selected and

included in the study. Primary data was gathered with aid of the questionnaire which was structured and it had undergone pilot-testing to ensure it was valid and reliable enough. The gathered data was analyzed through Statistical Package of Social Sciences version 24 supported by means and standard deviations, correlation and regression analysis. The following general regression analysis model was adopted during the processing of the findings:

LRP = β_0+ β_1IBCc1 +e

Where: LRP = Loan repayment performance

BCRs1 = Borrowers; Characteristics

In the model β_0 is the constant term while the coefficient β_1 is used to measure the sensitivity of the dependent variable (Y) to unit change in the independent variable (X1) e is the error term which captures the unexplained variations in the model

RESULTS AND DICUSSION

Response Rate

From the 45 questionnaires that were administered to respondents of the study, 33 were completely filled giving a response rate of 73.3%. This observation is consistent with Stedman, Connelly, Heberlein, Decker and Allred (2019) who shared that an above 70% response rate is good to support the analysis and presentation of the results in a survey.

Descriptive Statistics on Borrower's Characteristics

Descriptive statistics covering means and standard deviations on borrowers' characteristics were determined. Table 2 is a summary of the descriptive statistics on borrowers' characteristics.

Table 2: Descriptive Statistics on Borrower's Characteristics

	Mean	Std. Dev
High income SME borrowers have low probability of defaulting on their loans	3.78	.941
SME borrowers with stable income repay their loans on time	3.85	.765
Highly educated SME borrowers have low probability of defaulting on their loans	3.83	.833
There is low probability for young SME borrowers to default on their loans	3.79	.778
Middle aged SME borrowers have high probability of defaulting on their loans	3.73	.974
Relatively older SME borrowers are less likely to default on their loans	3.77	.875

The findings in Table 2 indicate that SME borrowers with stable income repaid their loans on time (M=3.85, SD=0.765) and that highly educated SME borrowers had low probability of defaulting on their loans (M=3.83, SD=0.833). Borrowers having low level of income are likely to default on their outstanding loan facilities with a lending institution (Thayaparan & Sivatharshika, 2019). It was noted that there was low probability for

young SME borrowers to default on their loans (M=3.79, SD=0.778) and that high income SME borrowers had low probability of defaulting on their loans (M=3.78, SD=0.941). According to Thayaparan and Sivatharshika (2019), borrower whose income is relatively higher and having bank account are less likely to default on their loans. The finding of the study indicated that relatively older SME borrowers were less likely to default on their loans (M=3.77, SD=0.875) besides the fact that middle aged SME borrowers had high probability of defaulting on their loans (M=3.73, SD=0.974). This finding is consistent with Thayaparan and Sivatharshika (2019) who noted that high probability of default is associated with borrowers in their middle age.

Correlation Results

Table 3 is an overview of correlation results providing the link between borrowers' characteristics and loan repayment performance.

Table 3: Correlation Matrix

		Loan Repayment Performance	Borrower's Characteristics
Loan Repayment Performance	Pearson Correlation	1	
Borrower's Characteristics	Pearson Correlation	.526	1

Table 3 indicates that borrowers' characteristics are strong and positive correlates of loan repayment performance among SMEs in Mogadishu, Somalia. There exists a dearth of empirical literature indicating that borrowers' characteristics are critical in influencing loan repayment performance of borrowers. These findings are consistent with Thayaparan and Sivatharshika (2019) who observed that borrowers' characteristics like family members, income and age predicted loan repayment performance in Sri Lanka. Within the context of Uganda, Ssekiziyivu, Bananuka, Nabeta and Tumwebaze (2018) obtained contradictory evidence that borrowers' characteristics and loan repayment performance are not significantly connected with each other. However, evidence from Ethiopia by Jote (2018) indicates that business experience, sex and age are all critical borrowers' attributes that significantly predict the loan repayment performance. Ogeisia, Musiega and Manase (2014) observed that borrowers' characteristics and loan repayment are strongly linked with each other.

Regression Results

Loan repayment performance among SMEs in Mogadishu Somalia was regressed on borrowers' characteristics and the findings were established and summarized as shown in Table 4.

Table 4: Summary of Regression Results

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	β	Std. Error	Beta		
(Constant)	.034	.007		4.543	.000
Borrowers' characteristics	.345	.103	.092	3.350	003

R=0.841 R2=0.708   Adj. R2=0.697

Table 4 indicates that 70.8% change in loan repayment performance among SMEs in Mogadishu, Somalia is explained by borrower's

characteristics. This means that in addition to borrower's characteristics, there are other additional factors that have an effect on loan repayment performance among the SMEs by 29.2% which should be the focus of future studies. The results in Table 4 further indicate that borrowers characteristics ($p<0.05$) are significant predictors of loan repayment performance. Therefore, hypothesis H01 was rejected. The finding contradict Ssekiziyivu, Bananuka, Nabeta and Tumwebaze (2018) who shared that borrowers' characteristics and loan repayment performance are not significantly connected with each other. On the other hand, evidence from Ethiopia by Jote (2018) indicates that business experience, sex and age are all critical borrowers' attributes that significantly predict the loan repayment performance. Ogeisia, Musiega and Manase (2014) observed that borrowers' characteristics and loan repayment are strongly linked with each other.

CONCLUSION AND RECOMMENDATIONS

Conclusion

SME borrowers with stable income repaid their loans on time. Highly educated SME borrowers had low probability of defaulting on their loans. SME borrowers having low level of income are likely to default on their outstanding loan facilities with a lending institution. It was noted that there was low probability for young SME borrowers to default on their loans. High income SME borrowers had low probability of defaulting on their loans. Relatively older SME borrowers were less likely to default on their loans. Middle aged SME borrowers had high probability of defaulting on their loans. The study observed that borrowers' characteristics are significant predictor of loan repayment performance among SMEs.

RECOMMENDATIONS FOR POLICY AND PRACTICE

The study recommends that credit officers working among financial institutions should critically and analytically appraise the borrower's characteristics like gender, age and level of income to qualify for loans. The borrowers among the financial institutions in Somalia should adhere to the principal of utmost good faith without concealing any specific characteristic that they have knowledge of.

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