

FACTORS THAT INFLUENCING DEFAULT LOAN REPAYMENT INTENTION AMONG MICRO-ENTREPRENEURS

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ABSTRACT

The expansion of Microfinance Institutions (MFIs) has experienced high growth and the implication is that increased competition could lead to a higher incidence of default. Since the borrower responsible for their own individual loan either in group lending and individual lending, intention are the best predictor as indications of a person's readiness to perform a specific behaviour. This study will identify the factors that causes from MFIs expansion such as motivation for future loan, family business capital, and self-efficacy towards double dipping that influence default loan repayment intention. The Theory of Planned Behavior is used as the focal theory. The empirical results of this study will assist in policy development eventually affects the sustainability capacity of MFIs.

Keywords: *Loan default, Intention, Motivation for Future Loan, Family Business Capital, Self-Efficacy towards Double-Dipping.*

INTRODUCTION

Microfinance institutions (MFI) have evolved as an economic development approach intended to assist financial assistance for microenterprises to obtain funds in developing and maintaining their business activities. Throughout Asia, Africa, and Latin America, the last decade has witnessed substantial efforts by MFIs that aim at opening the poor's access to credit yet at the same time lending to microenterprise remains laborious and daunting activity especially to improve their incentives to meet repayment obligations (Hwarire, 2012; Nawai & Shariff, 2013; M. Sharma & Zeller, 1997). Supported by Angaine and Waari (2014), despite the existing MFIs have tried to bridge the gap of credit accessibility to entrepreneurs, the entrepreneurs have been defaulting on their loans.

MFI schemes are operating in more than 100 countries (Abbas & Honghui, 2016) which estimated about more than 10,000 MFIs exist (Pereira & Mourao, 2012; Responsibility, 2017) and drawing a database from Microfinance Information Exchange (MIX) Market, it has reflecting 291 million clients worldwide

(Morduch, 2016). MFI consist of a wide range of institutions, from credit unions and cooperative to non-government organizations (NGO), government agencies, private companies and commercial banks (Shu-Teng, Zariyawati, Mokhtar, & Annuar, 2015). Identically, most of the MFIs are semi-formal or informal institutions that are not profit-oriented and they are generally dependent on subsidies from the government (Nawai & Shariff, 2012). This statistic shows that the salient feature of the microfinance movement is its rapid expansion. With increased MFI penetration, there has been a concomitant increase in competition among MFI (Guha & Chowdhury, 2012) as the implication also does lead to an increase in default rates (McIntosh, Janvry, & Sadoulet, 2004).

A microfinance loan default is undoubtedly a growing problem. According to data from Microfinance Information Exchange (MIX), total outstanding microloans rose from \$2.2 billion in 2000 to \$80 billion in 2011. It shows that a 37-fold increase overall, and equivalent to 39% growth per year (Kohn, 2013). Loan default or loan lower collection can caused a negative impact to the perspective of the borrowers, society, donors as well as the MFIs. It is been said that poor loan repayment can waste valuable funds and destroy a valuable service for the disadvantage and the community as a whole (Al-Sharafat, Qtaishat, & Majdalawi, 2013; Derban, Binner, & Mullineux, 2005). Ultimately, Woolcock (1999) state that a great number of failures among MFIs in many developing countries were due to their inability to ensure good repayment performance among their borrowers.

Most of the study as well proving that one of the main ways to encourage high repayment rates is through joint-liability lending, especially in the absence of collateral (Ghatak & Guinnane, 1999; Godquin, 2004), yet the theories of group liability also identifies pitfalls that are evident in practice. Thus, many MFIs eventually perceive it to be costly and restricting loan growth thereby resorted to individual lending method to enhance profitability (Widiarto, Emrouznejad, & Anastasakis, 2017).

Interestingly, together with the increasing competition due to MFIs expansion, many group MFIs also offer individual loan to prevent progressing clients from moving to competitors and to attract new clients (Dellien, Burnett, Gincheran, & Lynch, 2005), including pioneers Grameen Bank Bangladesh itself shifted to a new system known as Grameen II in 2002 and discarded joint liability (Hermes & Lensink, 2007). Some even shifted completely into individual lending, for instance BancoSol Bolivia (Cull, Demirguc-Kunt, & Morduch, 2007). Attracting better-off clients with individual lending is often done at the expense of the poorest (mission drift) (Armendariz & Szafarz, 2011; Cull et al., 2007). Nevertheless, the studies on individual based lending are especially rare, although it is increasingly implemented in MFIs (Hermes & Lensink, 2007) and little research examining the repayment behavior of small firms that actually receive loans (Deyoung, Glennon, & Nigro, 2006).

As access to financing is one of the challenges and constraint for the microenterprises to obtaining funds from financial institutions, it raises the question on what led to most of the micro-entrepreneurs' unwillingness to repay their loan even though they have been obtain such services from MFIs (both group and individual lending due to loan are per individual). This in turn, entails the question on what are the determinants of loan default repayment intention among micro-entrepreneur. To study the intention of micro-entrepreneur in loan default repayment is important as entrepreneurship scholars generally argue that entrepreneur behaviour is intentional and so best predicted by the measures of an individual (Bird, 1988).

The consequences of default repayment in MFIs has become a critical fundamental study and factors identification are important for the policymaker's justification on changes which need to be addressed in order to minimize defaults. Therefore, this study will examine the motivation for future loan, family capital and self-efficacy towards double dipping that influencing default loan repayment intention

among micro-entrepreneurs. It is expected that this research will advance current knowledge concerning micro-entrepreneur intention towards default loan repayment and to offer practical insights to sustaining MFIs in terms of managing their financial policy.

Default Loan Repayment in Malaysia

In Malaysia, microfinancing had broadly been developed to provide business financing to microenterprise, small and medium enterprises. Since the introducing of microfinance framework 2006, Bank Negara Malaysia and the participating financial institutions (FIs) have been actively promoting the microfinancing to improve the financing of microenterprise. The participation FIs are as Banking Institutions (BIs), Development Financial Institutions (DFIs) and Microfinance Institutions (MFIs) (Muridan & Ibrahim, 2016).

This research will focus on MFI as this institution played an important role to provide financial sources to microenterprises and was subsidised by the government since their existence (Mokhtar & Ashhari, 2015; Mokhtar, 2011). Since its inception in 2006 until end 2015, a total of 185,000 microenterprises have receives RM3.1 billion financing via 10 participating FIs (SME Corporation Malaysia, 2016). Important to realize, Malaysia MFIs is also one of developing country that suffers from high default rate.

The following table (Table 1) presents the financial performance of MFIs for 10 years from 2007-2016 based on statistic from Bank Negara Malaysia (2017). To calculate default in the context of microfinance loan, a repayment that has not been made is said to be default (Mukono, 2015). Accordingly, Rosenberg (1999) stated the repayment rate can be measured by collection rates measure amounts actually paid against amounts that have fallen due;

The table clearly shows the poor repayment collections especially in the year of 2016, approximately 81% have defaulted in repayments. According to Godquin (2004), the author stated that the first-level of repayment performance is a perfect (100%) on time repayment rate. Thus, the issue regarding the default loan are really needed to be addressed.

Table 1: Financial Performance of MFIs in Malaysia (2011- end-June 2017)

Year	Total Loan Repayment (RM million)	Impaired Financing (RM million)	Repayment Rate (%)
2011	347.9	1877.9	18.53%
2012	380.4	1763.6	21.6%
2013	379.9	1862.2	20.4%
2014	368.9	1829.6	20.16%
2015	358.2	1821.3	19.7%
2016	349.3	1823.2	19.2%
June-17	172.5	816.4	21.13%

Source: Bank Negara Malaysia, 2017

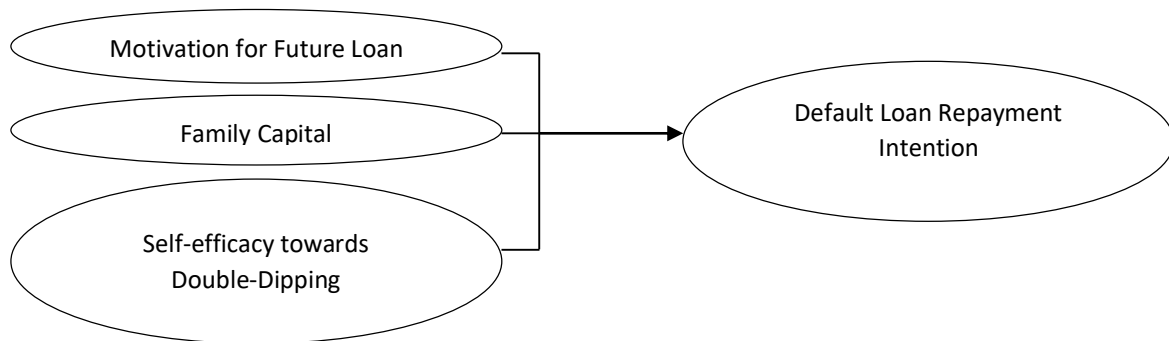
Irrespective of the type of lending whether individual or group, any institution planning to be in the business for a long time must pay attention to repayment. In such, monitoring default in a portfolio is important because it minimize the tendency of borrowers engage in moral hazard behaviour (Reinke, 1998). Thus, it is not surprising that the priority of most financial institutions is to maximize the level of loan repayment.

LITERATURE REVIEW

This section presents a proposed research model and the hypotheses in this study. Five constructs forming the basis of the model are discussed: motivation for future loan, family capital, perceived double-dipping, training and default loan repayment intention. The conceptual model detailed as shown in Figure 1.

An alternative approach to understand the default repayment intention of microenterprise is provided by the Theory of Planned Behavior (TPB). The TPB predicts that planned behaviors are determined by behavioral intentions which are largely influenced by an individual's attitude toward a behavior, the subjective norms encasing the execution of the behavior, and the individual's perception of their control over the behavior (Ajzen, 1991). Ajzen's theory has been used to predict an array of behaviors (Martin et al., 2010; Stone, Jawahar, & Kisamore, 2010). The authors extent to which individuals view a particular behavior positively (attitude), think that significant others want them to engage in the behavior (subjective norm), and believe that they are able to perform the behavior (perceived behavioral control), serve as direct determinants of the strength of their intention to carry out the behavior.

Figure 1: Conceptual Framework on Factors that Influence Default Loan Repayment Intention on Micro-entrepreneur



2.1 Motivation for Future Loan

Dynamic incentives have become a common measure in MFI to counteract the risk of default where incentives to repay are generated by granting access to future loans (Armendariz & Morduch, 2005; Shapiro, 2015), yet, this measure is largely remained unexamined (Dasgupta & Chowdhury, 2015; Godquin, 2004). One of the earliest papers which address the role of dynamic incentives in microfinance is Morduch (1999), who reports that the most practised dynamic incentive is increasing loan size over time.

The mechanism of dynamics incentive or progressive lending, as named by Armendariz and Morduch (2005), can manage credit risk both in group and individual loans.

Dynamic incentives consist of a threat and an opportunity which is the threat of being cut off from future loans and the opportunity of borrowing larger amounts in the future (Berglind & Karimi, 2007). This methodology is implemented herein to mitigate ex post moral hazard and strategic default, for instance borrowing without intention to repay the loan (Hermes & Lensink, 2007; Kono & Takahashi, 2010).

In the event of expansion and level of competition of the microfinance in the country, the important caveat here is that the borrower behaviour may be strategic in which the borrower intend to defaults when the number of alternative credit sources are available to them. This been supported by Morduch (1999), as the author stated that the competition and increasing mobility of borrowers will diminish the power of this mechanism (dynamic incentive) against moral hazard since borrowers will have the opportunity to take a loan elsewhere. Likewise, according to Field and Pande (2008), if the primary penalty for default and delinquency is denial for future loans, borrowers will presumably be more willing to risk bad behaviour as their outside options expand.

Important to realize, since the lenders are uncertainty as to how much a borrower values future loan as well as borrower's outside option and productivity growth, the main motivation for loan repayment is the borrowers' expectation for receiving future loans (Field & Pande, 2008; Shapiro, 2015). Empirical result studied by Mirpourian, Caragliu, Maio, Landoni, and Rusina (2016) supported the view that the repayment rate improves as borrowers get closer to the loan limit, which is the maximum available loan. In other words, motivation for reaching the maximum loan level is positively associated to the repayment performance.

Motivation is a dynamic process of internal psychological factors encompassing the needs, wants, and goals of an individual (Chan & Baum, 2007) and very powerful motive in entrepreneurship that direct to human behaviour for reaching to aim and tendencies (Locker & Baum, 2007). There are several ways in which motivation can be described, but motivation is broadly categorized as an intrinsic or extrinsic (Kong, 2009). Intrinsic motivation is the one in which task performance is for the sake of task performance, while extrinsic motivation involves an element of external reward. In other words, in the extrinsic motivation goals are of interim type at the service of a much more important achievement (Brown, 1994). Most compelling, Armendariz and Morduch (2010) emphasize reputation-based measures, known as dynamic incentives, which appeal to the intrinsic borrowers.

Notably, based on TPB, intention is an indication of a person's readiness and willingness to perform a given behaviour, and intentions capture the motivational factors that influence behaviour (Ajzen, 1991). This paper argues that potentially interesting elements, so far relatively neglected in the extant literature, are the motivational issues, particularly motivation for future loan that may influence the default repayment intention of micro-entrepreneur. Therefore, a hypothesis can be formulated in the following manner:

H1: There is negative significant relationship between motivation for future loan and the default loan repayment intention among micro-entrepreneur.

2.2 Family Business Capital

The dominant theory of microfinance has focused on group lending that received the most attention as it is an innovative to alleviate the problems of adverse selection and moral hazards. Cassar, Crowley and Wydick (2007) show that social ties, relations and trust among members in group lending, which are often being referred to as social capital contribute to high repayment rates. Social capital to the extent it plays a role and interpreted as enhanced enforcement capacity in multi-period game and not surprisingly, increases repayment (Besley & Coate, 1995). The term of social capital are used in two different senses. In the first, it is just another name for “implicit contracts” or “social contracts” enforced through a repeated game, where the members of the society (group) have strategies that serve to enforce the desired behaviour (Varian, 1990; Stiglitz, 1990; Godquin, 2004; Fukuyama, 2001). Second, interpretation of social capital sees being connected, and maintaining the affection and respect of those with whom one is closely connected, as an essential aspect of advancing one’s own sense of well-being (Putnam, 1995).

Indeed most the study as well proving that one of the main ways to encourage high repayment rates is through joint-liability lending, especially in the absence of collateral Ghatak and Guinnane (1999), Godquin (2004), yet the theories of group liability also identifies pitfalls that are evident in practice. Group lending in practice suffer from some disadvantage such as domino effect or risk of contagion if one of the members is unable to meet repayments (Armendariz & Morduch, 2010; Churchill, 1999). The criticism is mainly because the whole groups are responsible for the repayment of it (Armendariz & Morduch, 2010). In other cases, it may be that the borrower's assessment of his or her peers' likelihood of defaulting triggers the borrower's own decision to default (Besley & Coate, 1995).

As such, the strength or weakness of the linkages of the individual or organization with other individuals is an important elements related to social capital (Granovetter, 1985). Social capital has multidimensional levels which are the country-level social capital and individual social capital (Tatarko, 2013). Country-level social capital in the form of trust provide more favourable conditions for entrepreneurship, and the successful development of entrepreneurship increases the welfare of the nation as a whole (Kwon & Arenius, 2010). Meanwhile, individual social capital is “the collection of resources owned by the members of an individual's personal social network, which may become available to the individual as a result of the history of these relationships” (Van Der Gaag, 2005).

Nevertheless, studies conducted by Karlan, Mullainathan and Robles (2011), the author used a survey to explore the relationship between psychological measures of social capital to predict default in individual loans as compared to previous study that measure of social capital to predict default on group loan (Karlan, 2005), and the results shows that the social capital is less predictive in individuals loans, which make sense since the burden of default falls on the bank and not the individuals within the participants’ social network.

Thus, this paper will focus on individual social capital as it is more heavily affects people's behavior (Van Der Gaag, 2005; Verhaeghe & Tampubolon, 2012) and emphasized on social forms of capital including family capital. Family capital is considered to be a special type of social capital that exists in family relations (Parcel & Menaghan, 1993). Family members give social resources to a person, which help to develop their business, as well as provide social support (Anderson & Miller, 2003). Several studies asserted that family plays an important role in inclined individual intention, for instance, the career choice preference of individual in determining entrepreneurial intention especially family business and society (Geldereren et al., 2008; Leffel & Darling, 2009), family background motivating and influencing young graduates’ intention to become agri-entrepreneurs (Sharma, 2014). Thus, this paper proposed:

H2: There is negative significant relationship between family capital and default repayment intention among micro-entrepreneur.

2.3 Self-efficacy towards double dipping

Other central issue in this study is the growth of MFIs that leads to borrowers having and easier access to credit. Owing to this matter, this phenomenon had closely connected to double dipping (multiple loans) and default repayment among the micro-entrepreneur (Armendariz & Morduch, 2005; McIntosh et al., 2004; Shapiro, 2015). This is due to MFIs compete for borrowers and, therefore, weaken screening norms for borrowers - making it too easy for poor borrowers to obtain credit (Lahkar & Pingali, 2016).

Given the preceding results regarding the impact of increased MFIs competition and double-dipping, notably, Guha and Chowdhury (2013) provide a model with double-dipping where borrowers face ex-ante moral hazard, and taking more than one loan is always inefficient and always leads to default. On the other hand, result from Abbas and Honghui (2016) shows that there is strong negative correlation between multiple loans and loan repayment in MFIs. Consequently, it means that taking multiple loans within the same MFI or different MFIs is not directly leading to problem in loan repayment.

It is therefore this study intriguing whether individual self-efficacy towards double-dipping will reduce the default loan repayment rates. The term self-efficacy derived from Bandura (1977) social learning theory, refers to a person's belief in his or her capability to perform a given task. An individual's perception of self-efficacy has a strong influence on how he or she will act and how the available knowledge and skills will be utilized. Additionally, an individual's self-efficacy has also been argued to be a significant driver of entrepreneurial intentions (Krueger, 1993; Krueger & Brazeal, 1994; Markman, Balkin, & Baron, 2002; McMullen and Shepherd, 2006). Thus the hypotheses are:

H3: There is negative significant relationship between self-efficacy toward double dipping and default repayment intention among micro-entrepreneur.

CONCLUSION

This study has developed a comprehensive conceptual framework which examines the factors that influencing default loan repayment intention among micro-entrepreneurs in Malaysia. To the best of the author's knowledge, this is the first time such a framework will be tested comprehensively. Previous studies conducted by Shapiro (2015), present descriptively the two constructs that affect MFIs loan repayment and defaults, such as dynamic incentive and double dipping. In contrast, for the first time, this study establishes an integrative conceptual model comprising, namely motivational for future loan, family capital, and self-efficacy towards double dipping, and default loan repayment intention. Additionally, this study provides essential lessons on default loan repayment intention by applied Theory of Planned Behavior as the focal theory to examine the relationship between the factors and intention.

This study provides some indicators to the government and financial institutions, particularly MFIs in terms of managing their financial policy and investing into program that need to be instilled through training and promoted in the future generations to avoid being indebtedness.

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