CHAPTER ONE
GENERAL INTRODUCTION
1.0 Background to the Study

A Microfinance Institution's main objective is to provide poor (MFI and low income households with an affordable source of financial services. Interest charged on loans is the main source of income for these institutions, and because they incur huge costs, the rates are correspondingly high. Four key factors determine these rates: the cost of funds, the MFI's operating expenses, loan losses, and profits needed to expand their capital base and fund expected future growth (Ghatak, 1999).

Many policy makers question why microfinance interest rates remain high even when some MFIs receive concessional funds to finance lending. Although some micro lenders receive loan funds at concessional rates, they must cost these funds at market rates when they make decisions about interest rates to ensure the sustainability of the institution's operations. Donors provide concessional funds for a particular usage only for a limited period, as do some governments. However, concessional funds cannot be considered a permanent source of funds for MFIs, and provision must be made through interest rates to sustain the lenders' operations (Ghatak, 1999).

Inflation adds to the cost of microfinance funds by eroding microlenders' equity. Thus, higher inflation rates contribute to higher nominal microcredit interest rates through their effect on the real value of equity. Microlenders have two kinds of operating costs: personnel and administrative. Because microlending is still a labor-intensive operation, personnel costs are high. Administrative costs consist mainly of rent, utility charges, transport, office supplies, and depreciation of fixed assets. Making and recovering small loans is costly on a per unit basis. Often loan recovery is executed by staffs who visit clients, increasing costs in time taken and transportation used. Poor physical infrastructure—inadequate road networks, transportation, and telecommunications systems—in many countries in which microlenders operate also increases administrative costs and adds significantly to the cost of microfinance operations. Inadequate law and order also contribute to high administrative costs as microcredit operations often involve cash transactions and the physical movement of cash (Pitt, and Khandker, 1998).

In many countries, the majority of microcredit is provided by a few leading institutions, and competition among them is mostly on non-price terms. This might not be the case in Nigeria where Microfinance Institutions...
(MFIs) spring up every day. Today in Nigeria the MFIs compete with traditional Banks in the cities as well as have dominance in the rural areas. Large-scale commercial banks with access to low-cost funds, low operating costs, extensive branch networks, and vast human and other resources to provide financial services efficiently are presently not significantly involved in microcredit. The lack of participation of such conventional financial institutions in the microcredit market also limits potential competition. Although it is widely recognized that microfinance alone will not end poverty, it is a vital step in that direction. Microfinance institutions, also known as MFIs, offer financial services to underserved, impoverished communities. Previously, entrepreneurs seeking loans in impoverished communities had to provide collateral to borrow from unlicensed lenders at inequitably high interest rates. A number of factors, including high administrative costs relative to small loans and small returns, had kept banks from setting up branches in impoverished communities when surer profits were to be had elsewhere. The lack of an efficient financial services industry has held back many would-be entrepreneurs with viable business plans from realizing their own potential. Women, in particular, have been excluded as loan candidates in developing communities. The lending practices of many emerging microfinance institutions have given people living in extreme poverty the opportunity to realize their potential in the business community (Rahman, 1999).

1.1 Problem Statement
Charging prices high enough to cover costs is essential for any business to survive in the marketplace. This is true for institutions providing microfinance services as it is for any other enterprise. Thus, it is not surprising that many successful microfinance institutions charge high interest rates to cover their high costs. However, despite the success of those institutions in expanding the supply of credit during the last two decades to an increasing number of poor and low-income households, most borrowers default in paying back those MFI loans.

Studies into microfinance in Nigeria did not concentrate on the effect of interest rate on loan repayment on Microfinance Institutions even at the time when MFIs are finding it very difficult to collect loans which have been given to beneficiaries is receiving much attention. This creates a serious research gap into microfinance of which this study seeks to close.

1.2 The Objectives of the Study
The objective of this study is to appraise the effect of Interest on loan repayment in Microfinance Institutions in Nigeria which includes:
1. To appraise the effect of MFI interest rate on repayment of loans.
2. To determine the effect of other factors on MFI loan repayment.
3. To appraise the factors that determine interest rate by MFIs.
4. To appraise the measures adopted to enhance the repayment of loans of MFIs.

1.3 Research Questions

Related to the problem, the research seeks to address four main questions outline below:
1. What is the effect of high interest rate of MFI on the repayment of their loans?
2. What is the effect of other factors on MFI loans repayment?
3. What are the factors that determine interest rate by MFIs?
4. What measures adopted by MFI to enhance the repayment of loans?

1.4 Significance of the Study

The significance to be derived from the study includes:
Providing the management of TCP and other MFIs with an insight into the effect of interest rates on loan repayment and recommendations to make adjustments where necessary. It will also assist TCP and other MFIs to identify the other factors that also impact on loan repayment to enable them achieve a competitive edge in their respective businesses. This study can be used as reference for further research. By conducting a research on a related subject, this study would serve as a platform to enhance their work. It will serve as a rich source of literature to other researchers, and the limitation of this research may be built on by others studying on the same topic. It is also hoped that findings from this research would confirm or refute the existing knowledge about the effect of interest on loan repayment on MFIs especially Tanoah Capital Point Limited.

Though this research is to partially fulfill an academic requirement for the award of a masters degree, it is expected that recommendations would be provided to complement regulatory bodies and government’s MFIs problem effort of repayment of in loans which addressi serve as a negative in the development of small and medium enterprises.

1.5 Scope of the Study

The study was conducted within the framework of the effect of interest rate on loan repayment on Microfinance Institutions. The study was carried out at the Tanoah Capital Point (TCP) Limited branch in Ikot Abasi. It is a case study approach of one particular MFI (TCP) and would not cover other MFIs to reflect the entire industry response to the effect of interest rate on loan repayment on MFI. Hence the results would not be generalised but its findings would be placed in the relevant context of the individual MFI studied.

1.6 Limitation of the Study
A project of this nature requires an extensive study of all microfinance companies in the metropolis. This requirement is constrained due to the dispersed nature of these companies and the lack of time and funding. Furthermore, the trustworthiness of respondents especially clients of the company cannot be guaranteed, since personal opinion can influence responses. In view of these limitations, however, it can serve as a useful input into decision and policy making.

1.7 Organisation of the Study
The research work is divided into five (5) chapters.

Chapter one, is dedicated to the introduction and research context. Further relevant sections have addressed the statement of the problem, research questions, and the objectives of the study, significance of the study, scope and limitation of the study. Chapter two, is devoted to literature review, various views from different authors were reviewed as regards the effect of interest on loan repayment on MFIs and definition of variables. Chapter three concentrates on the background of the study area and the methodology of the research. Chapter four focuses on the Findings, Analysis and Discussions of Results. Chapter five covers the summary, conclusion and recommendations.

THE EFFECT OF INTEREST RATE ON LOAN REPAYMENT IN MICRO FINANCE BANKS IN NIGERIA

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