

# Loan Repayment Ability of Farmers in Sri Lanka: Exploring North Central Province

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**Abstract:** Current study examined factors affecting to farmers loan repayment ability in North Central Province. While dependent variable was loan repayment and independent variables were information about income, information about loan amount, background investigation, time taken to lend money and information about guarantee. The collected data were analyzed by using reliability test, descriptive analysis, correlation analysis and multiple linear regression analysis. The result was generated from answers taken from 125 randomly selected borrowers in North Central Province area and data were analyzed through SPSS software. According to regression result of the performing loan holder sample which shows that information about guarantee significantly affect to the loan repayment. Total sample of this study reflect that background investigation and information about guarantee have significant effect on loan repayment and there is no significant effect of information about income, information about loan amount and time taken to lend money on loan repayment. Finally this study concluded that background investigation and information about guarantee are the factors which significantly affect for the loan repayment.

**Keywords:** Loan Repayment Ability, Farmers, North Central Province, Borrowers.

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## 1. INTRODUCTION

Farmers play onerous role within the Sri Lankan context but farmers cannot play their role correctly due to financial problems. Credit is most important source for the farmers to establish and expand their farms. Hence accessing to credit is one of key element to increase agriculture productivity. (Ojiako and Ogbukwa 2012). Loaning is a risky enterprise because repayment of loans can infrequently be fully guaranteed. Generally most of farmers are failing and face number of problems within the repayment stage (Awoke, 2004). However credit provides the financial resources to the poor farmers take advantage of the profitable investment opportunities in their immediate environment (Zeller and Sharma 1998). Banks are the key providers of financial services to the low income entrepreneurs and farmer. Banks should make a credit investigation and analysis of the character and financial position of each borrower. Because banks deems to be adequate to cover any risk of loan default (Papias & Ganesan, 2009) According to Nwagbo (1980) Most of poor people access credit from formal financial source based on their experience and government policy due to internal problem of small scale farmers and operational practices. Loan process good mechanism to allocate resource among people but loan processes do not proceed successfully with in the society which will cause to increase number of problems within the society. Main problem is available resources were not efficiently allocate among people through loan mechanism; Loan Mechanism will stimulate the necessary conditions to achieve economic growth and development. But if the allocation method and use the savings are undesirable, it does not provides favorable symbol to economic growth and development and will cause of disaster (Haghighat and Nasiri, 2004).

## 2. RESEARCH PROBLEM

Agriculture economy is play major role within the developing country economy but the problem is people who are engaged with the agriculture economy is poor and they do not have sufficient financial capabilities to address agriculture requirements therefore most of farmers link with financial institutes to take loans. According to above reason government

and financial institutes have to give higher consideration about agriculture loan. Lack of access to credit is generally seen as one of the main reasons why many people in developing economics remain poor. Usually the poor have no access to loans from the banking system because they cannot put up acceptable collaterals because the costs for banks of screening and monitoring the activities of the poor and enforcing their contracts are too high to make lending to this group profitable (Hermes and Lensink, 2004). As same as developing countries maintain high regulation against their borrowers due to this reason most of financial institution face high default risk therefore important to know the loan repayment capacity of farmers to modify regulation and to decrease default risk

Loan repayment will be a vital problem to financial institutions because entire business procedure of financial institution depends on borrowing and lending money. If the financial institutions have not proper establishment of loan recovery procedure to cover their loans, they will face huge financial problems. Because loan help to create lack of funds in future. The problem statement of this study is: "To identify factors affecting to farmers loan repayment ability evidence from in NCP" The main objective of the study is to identify the factors affecting to farmers loan repayment ability from NCP. In addition understand the nature of factors affecting loan repayment of the financial institutes.

### **3. THEORETICAL CONSIDERATIONS AND EMPIRICAL EVIDENCE**

A bank loan is a form of credit which is extended for a specified period of time, usually on fixed interest terms related to the base rate of interest, with the principal being repaid either on a regular installment basis or in full on the appointed redemption date. Depending upon the nature of the loan and the degree of risk involved, a bank loan may be unsecured or secured, the latter requiring the borrower to deposit with the bank an approved form of collateral security (Pass et al., 2002).

People can lend money through formal or informal source mainly small scale organizations fulfill their financial requirement through informal source. Informal financial markets are much closer to their clients and potential clients through gossip and daily contact they are much more aware about their client's activities than a formal banker due to this reason probability of default of small scale enterprises credit from informal market rather than the formal market. On the other hand small scale taken loan from formal financial markets has experienced a high rate of default in many developing countries for example Mali, Benin, Liberia, India, Nigeria, Malawi, and Peru (Fry, 1995).

Loan repayment is the act of paying back money previously borrowed from a lender. Repayment usually takes the form of periodic payments that normally include part principle plus interest in each payment. Failure to keep up with repayments of debt can force a person to declare bankruptcy and severely affect his credit rating ([www.investopedia.com](http://www.investopedia.com)). Loan delinquency refers to failure of borrowers to repay their debts on time or to repay them at all. Loan delinquency is a serious problem of rural credit programs because it results in a waste of manpower, high administration costs and slow turnover of resources. The main reasons for loan delinquency are failure of projects, low income of the borrowers and natural disasters (Okorie, 2004).

Empirical finding of the Zeller and Sharma (1998) was done this research using tobit model. Information has been obtained by the household, group and community level. The result showed that groups with higher levels of social have a better repayment rate. The result also lead to the conclusion that it is not the level of physical and human assets of the group members but the degree of variance of risky assets among members that contribute to better loan repayment.

According to the Abafita (2003) was done a research on Microfinance and loan repayment performance using case study of the Oromia Credit and Savings Share Company (OCSSCO) in Kuyu. In this research methodology, he used a logit model to find the factors influencing on loan repayment performance in the micro finance institution. The sample size is 203, which is 9.3 percent of the total beneficiaries of the micro finance institution. The independent variables used on the research includes, age of borrower, sex of borrower, educational level of borrower, loan size, timeliness of loan release, loan diversion rate (ratio of loan diverted to total loan receive, income from activities financed by loan (annual), annual income from other activities (not financed by the loan), value of livestock, suitability of repayment period, use of financial records, adequacy of supervision visits made to a borrower, location of residence of borrower, number of dependents number of times borrowed)

According to the Roslan and Zaini (2009) were found that the determinants of microcredit repayment in Malaysia in agro bank micro credit scheme. The characteristics of the borrowers are gender, marital status, race, level of education, age, occupation, number of dependents, experience, membership in business society and training. The characteristics of the project are ownership structure of the project, type of the project, distance of the project to nearest agro bank office, and

revenue from project. The loan characteristics are amount of loan and length of repayment period. Primary data was used to doing this study. Data were collected through a survey carried out among agro-bank micro credit scheme borrowers in 86 branches of agro bank throughout Malaysia.

#### 4. DATA AND METHODOLOGY

The study of farmer's borrowing behaviour towards Repayment Ability was examined in North Central Province. The study is qualitative type comparative analysis. According to the literature survey, dependent variable is the loan repayment and independent variables are the information about income, information about loan amount, background investigation, time taken to lend money and information about guarantee. The population of the study was all loan holders in North Central province in which 125 borrowers were selected as sample based on stratified sampling method .The questionnaire was used to collect information from the sample. It includes thirty four closed end questions and categorized those under seven parts. The questionnaire consists multiple questions, dichotomous questions and 'Likert Scale' questions. Likert scale range from one to five points. One represents strongly dissatisfied and five represents strongly satisfy. The questionnaires were analyzed through SPSS software and employed descriptive, correlations and regression analysis to derive accurate findings.

#### 5. RESULTS AND DISCUSSION

According to the demographic analysis 56% male borrowers and 44% female borrowers and most of borrowers were more than 35 years old and more borrowers have good education background. Reliability test was performed to identify the reliability of each construct which was used to measure the research variables. Cronbach's alpha was used for reliability analysis. Current study reliability test reflected all variable Cronbach's alpha value were greater than the 0.7 hence study accepted those variables to address research question.

According to the descriptive analysis, the mean value of the information about income, information about loan amount, background investigation, time taken to lend money, information about guarantee and loan repayment were 4.1422, 4.1050, 4.2647, 4.0176,4.0784 and 4.2255 respectively. These values indicate for all variables that the respondent's satisfaction level of 4 (satisfy level) regarding this independent and dependent variables. So, mean value of this sample has distributed to 4-5.

The correlation analysis, which was used to identify relationship between independent variable and dependent variables and analysis the factors associated with the loan repayment. Pearson's correlation was one of the tools used to test research question.

**Table 01: Correlations Analysis**

	Correlations					
	IM	LAI	BGI	TTL	IG	LR
IM	1					
LAI	0.616	1				
BGI	0.484	0.434	1			
TTL	0.237	0.297	-0.041	1		
IG	0.585	0.453	0.158	0.297	1	
LR	0.574	0.429	0.400	0.192	0.569	1

Based on above table the correlation between loan repayment and information about income was 0.574 which significant at 0.000. It indicates that there was a positive and significant relationship between loan repayment and information about income. The correlation between loan repayment and background investigation is 0.400 and significant at 0.000. It appears that there is a positive and significant relationship between loan repayment and background investigation as same as loan repayment and information about loan amount and loan repayment and information about guarantee also reflects positive significant relationship. The correlation between loan repayment and time taken to lend money was 0.192 and there was significant relationship between loan repayment and time taken to lend money

According to ANOVA analysis F value in the model was 11.331, significant at the 0.000, because it had above 5% of F value. The result shows that there was significant relationship between variables. So the overall regression models for the independent variables were good model to explain the loan repayment. R value was 67.1%. The R value represents the positive correlation between independent variables with loan repayment. R square value was 45.1% with loan repayment. And also adjusted R square value was 41.1%. It implies that the model was appropriate to show the relationship between independent variables and dependent variable. It shows that 41.1% variance of the loan repayment explained by the independent variables and 58.9% of the variation of loan repayment was unable to explain the variance of the independent. That indicates the other factors affect the loan repayment of the borrowers than independent variables of this study.

**Table 02: Coefficient Analysis**

Variables	Unstandardized Coefficients of B	Sig.
(Constant)	0.156	0.813
Information about income	0.288	0.100
Information about loan amount	0.006	0.968
Background investigation	0.251	0.039
Time taken to lend money	0.037	0.752
Information about guarantee	0.402	0.001

The table shows the coefficient result of the loan repayment result with independent variables. After applying multiple linear regression result of the variables of the above table, the regression model in the chapter three can be developed as follows,

$$LR=0.156 + 0.288 IIM + 0.006 ILA + 0.251 BGI + 0.037 TTL + 0.402 IG$$

From the equation, if one unit of information about income increased, it will lead to increase of 0.288 in loan repayment. If one unit of information about loan amount increased, it will leads to increase of 0.006 in loan repayment. If one unit of background investigation increased, it will lead to increase of 0.251 in loan repayment. If one unit of time taken to lend money increased, it will lead to increase of 0.037 in loan repayment. If one unit of information about guarantee increased, it will lead to increase of 0.402 in loan repayment. According to multiple regression analysis of the above table, 0.156 was the constant value of this model. It represents the value of loan repayment at zero level of all independent variable at the model. In here results indicates that there was a positive relationship between information about income and loan repayment and significant at 0.100. There is a positive relationship between information about loan amount but it also not significant. Background investigation and information about guarantee positively, significantly affect to loan repayment according to the result. There was a positive relationship between time taken to lend money and loan repayment but relationship was not significant.

According to the correlation and regression analysis result reflects Background investigation and information about guarantee variables were strongly affect to farmer's repayment ability rather than the information about income and information about loan amount but time taken to lend money factor did not considerably affect to farmer's repayment ability.

## 6. CONCLUSIONS

This study was done to identify factors affecting to farmer's loan repayment ability evidence from NCP. Data were collected using the questionnaire from North Central Province. Questionnaires were included seven parts of questions. These questions are related to the demographic factors, information about income, information about loan amount, background investigation time taken to lend money, information about guarantee and loan repayment. The survey results were analyzed by validity test, descriptive analysis which includes mean and standard deviation of dependent and independent variables, correlation analysis and regression analysis. According to the analysis researchers found following

results. The survey results of the validity test revealed that all the dependent and independent variables in line with the acceptable level. The results of the descriptive analysis revealed that the respondents' satisfaction level has distributed from four to five. The result of the correlation analysis interpreted that information about income, information about loan amount, background investigation and information about guarantee are significant. The variable of time taken to lend money is not significant. According to the multiple regression analysis, the variables of background investigation and information about guarantee are significant. Other variables of information about income, information about loan amount and time taken to lend money are not significant.

In order to increase loan holders' performance in loan repayment, researchers recommended following strategies based on the finding of this research. Credit holders do not disclose the actual reason for the borrowing when they borrow from bank. And also they do not disclose actual income which is earned from their occupation. These reasons affect to the loan repayment therefore bank should investigate and examine the reasons for borrowing and credit holders' income. Then bank can reduce giving unnecessary loans to the borrower. Bank should give simple guarantee conditions and suitable guarantee to the loan holders and release loan within shorter time period. Loan holders are satisfy when bank release loan within shorter time period Then it affect to the loan repayment of borrowers. Borrowers less use loan to fulfill their actual purpose of borrowing loan. It causes to generate expected income from particular project. So this affect to the loan repayment. Natural disasters cannot prevent the borrowers or bank. Then it causes to collapse income. Therefore to avoid breakdown income, bank provides loan for the borrowers which they carry on their project continuously. Bank should maintain effective loan supervision mechanism to review borrowers. Then bank can ensure loan repayment of loan holders.

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