INTERNATIONAL JOURNAL OF MULTIDISCIPLINARY: APPLIED BUSINESS AND EDUCATION RESEARCH
2023, Vol. 4, No. 10, 3697 – 3702
http://dx.doi.org/10.11594/ijmaber.04.10.22

Research Article

Perceived Credit Risk of Micro Finance Loans among Micro-enterprises Business in Población Iligan City

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Article history:
Submission October 2023
Revised October 2023
Accepted October 2023

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ABSTRACT

This study aimed to assess the perceived credit risk associated with microfinance loans among micro-enterprise businesses. It had three primary objectives: first, to profile the respondents based on their demographics; second, to gauge their perceptions regarding the credit risk and of the microfinance loans. The research employed a descriptive-correlational research design and was conducted in Brgy. Poblacion, Iligan City, involving a random sample of seventy-five business owners who completed an adapted and modified survey questionnaire. The findings revealed that a majority of the business owners were elderly individuals aged 51 years and older, primarily running cafeteria businesses. Many of these business owners had availed of microfinance loans for their enterprises, and a significant portion had recently experienced this process. It is noteworthy that the majority of micro-borrowers have limited incomes and a lack of substantial credit history. Over time, the microfinance sector has adopted risk mitigation strategies like group lending models and accepting specific collateral types.

Moreover, microfinance institutions have expanded their lending to microenterprises, assessing their creditworthiness based on cash flows. In conclusion, this study suggests that factors such as age, business type, prior loan utilization, and loan experience do not significantly influence individuals' perceptions of credit risk associated with microfinance loans. Thus, other unexplored factors may play a more prominent role in shaping how individuals perceive the credit risk in microloans.

Keywords: *Credit risk, Finance loan, Micro-Enterprises*

How to cite:
Juventud, W. M., Matigas, E. A. O., Himongala, J., Galla, M. R., & Abiol, M. J. D. (2023). Perceived Credit Risk of Micro Finance Loans among Micro-enterprises Business in Población Iligan City. *International Journal of Multidisciplinary: Applied Business and Education Research*. *4*(10), 3697 – 3702. doi: 10.11594/ijmaber.04.10.22

Introduction

Microfinance is a financial approach designed to provide banking services to underserved groups and individuals who struggle to access traditional financing due to factors like poverty or geographical location. This concept operates outside conventional constraints to offer capital to small businesses and individuals who would otherwise be ineligible for such financial support. By providing financial services to small businesses, microfinance plays a crucial role in poverty reduction. It empowers disadvantaged households to accumulate assets, increase their income, and reduce vulnerability to economic hardships and external shocks. Microfinance helps households manage their cash flow, boost disposable income, and plan investments, ultimately improving living conditions, healthcare, and education. To enhance microfinance services, business development services come into play. These services assist rural households in building financial and business management skills, improving technical expertise, offering local support for marketing, and bridging the gap between forest communities and microfinance services. Business development services need to evolve in sync with the growth of small businesses to address their evolving needs. Microfinance institutions are increasingly recognized as practical tools for poverty reduction, emphasizing the vital role they play in supporting economic growth and improving the livelihoods of marginalized communities.

Methodology

For this study, the research adopted a descriptive-correlational approach, which enabled a comparative analysis of two variables. This method facilitated the exploration of both the similarities and differences between the two groups, enhancing comprehension of the study's subject matter. The research was conducted at Poblacion Wet Market in Iligan City, Philippines. Poblacion is a barangay in Iligan with a population of 3,613 as per the 2020 Census, comprising approximately 1.00 percent of the city's total population. A simple random sampling design was employed to select respondents from the barangay. Simple random sampling ensured that every individual in the population had an equal chance of being chosen. Seventy-five (75) vendors were randomly selected as survey respondents from Poblacion Wet Market in Iligan City.

The study utilized an adapted and modified questionnaire to assess financial literacy. An adapted and modified questionnaire was used to assess financial literacy in this study. Santosh Kumar Das and Khushboo Uppal, Thomas R. Piper, and Wolf A. Weinhold created the questionnaire (2014). The questionnaire was then checked for its face and content validity index. Questions were presented in Bisaya, the local language, to ensure respondents' understanding and honest responses. The questionnaire was divided into two sections: the profile section, capturing socio-demographic characteristics like age, business type, microfinance lending utilization, and loan experience, and the functional questionnaire section, offering respondents choices to reflect their answers based on the provided options. A Likert scale approach was employed to score the investigation. The Likert scale measures the intensity and severity of respondents' agreement or disagreement with the provided statements, progressing from "Strongly Disagree" to "Strongly Agree." Four statistical tools were used: Cronbach's alpha, Frequency Distribution, Mean and Standard Deviation, and Pearson Product Moment Correlation. Cronbach's alpha assessed the survey questionnaire's reliability. Frequency and percentage facilitated the description of respondents' socioeconomic profiles. Mean and Standard Deviation were utilized to evaluate respondents' perceptions of financial literacy.

Results and Discussion

Table 1 Perceived Credit Risk of Microfinance Loan in terms of Default Risk

	Mean	Standard Deviation	Description
As a borrower, you are aware of the lending rules	3.95	0.22	*Strongly Agree*
As a borrower, your income is insufficient to pay off the loan	3.48	0.62	*Strongly Agree*
It is suitable for you as a borrower to apply for a lending loan even if you are aware that is risky	3.27	0.93	*Strongly Agree*
The outcome of applying for a lending loan is favorable for the borrower.	3.08	0.85	*Agree*
The lending loan has a significant impact on small businesses as a borrower	3.51	0.62	*Strongly Agree*
Average	***3.46***	***0.51***	***Strongly Agree***

The table indicates the perceived default risk associated with microfinance loans. Respondents strongly agree (3.46) that microfinance loans carry a default risk, suggesting that borrowers are aware of the lending rules. Researchers have confirmed that borrower information, including FICO scores and loan-specific characteristics, such as interest rates and time on the books, are crucial predictors of default events in marketplace loans. Advanced approaches like random forests and gradient-boosted trees have shown superior model performance compared to logit regression methods. Additionally, delinquency movement models help dynamically estimate a loan's potential performance based on its status (2020).

Table 2. Perceived Credit Risk of Microfinance Loan in terms of Credit Spread Risk

	Mean	Standard Deviation	Description
As a borrower, the government is risk-free	3.57	0.52	*Strongly Agree*
A good relationship between lenders and creditors during and after payments.	3.85	0.36	*Strongly Agree*
Borrower interest rates are higher than government interest rates.	3.59	0.49	*Strongly Agree*
Borrowers are aware that the creditor conducts a background check before lending.	3.79	0.53	*Strongly Agree*
The loan has provided many benefits to people as borrowers.	3.11	1.23	*Agree*
Average	***3.58***	***0.27***	***Strongly Agree***

The table presents the perceived credit spread risk associated with microfinance loans. Respondents strongly agree (3.58) that microfinance loans carry a credit spread risk, indicating a positive relationship between both parties during and after repayments. The determination of credit spread is influenced by the presence of a single regime throughout the sample period, which limits its explanatory power. Researchers have found that market, default, and liquidity factors are more effective in models with endogenous regimes for credit spreads or monetary regimes due to their interaction with the regime. (Chun et al., 2014).

Table 3 Perceived Credit Risk of Microfinance Loan in terms of Downgrade Risk

	Mean	Standard Deviation	Description
I expect an overall increase in my bank's profitability in the next 6-12 months.	3.27	0.58	*Strongly Agree*
I am more comfortable putting my money in a bank account than in the share market.	3.17	0.58	*Agree*
If the bonds issued are downgraded, the price and prospects of a company or government can suffer significantly	2.99	0.80	*Agree*
My current earnings are covering the cost of equity.	3.33	0.64	*Strongly Agree*
The biggest drawback to a downgrade is a higher cost of capital for both debt and equity.	3.24	0.54	*Agree*
Average	***3.20***	***0.32***	***Agree***

The table displays the perceived downgrade risk associated with microfinance loans. Respondents generally agree (3.20) that microfinance loans entail downgrade risk, indicating that their current earnings sufficiently cover the cost of equity. Research by Kang (2021) suggests that credit rating downgrade risk has a negative impact on acquisition decisions and a positive effect on performance for investment-grade firms, particularly those teetering on the edge of being downgraded to non-investment grade (BBB-). However, these relationships are insignificant for non-investment-grade firms.

Table 4. Perceived Credit Risk of Microfinance Loan in terms of Concentration Risk

	Mean	Standard Deviation	Description
I rely too much on a single investment or portfolio of different kinds of securities and asset classes	3.32	0.62	*Strongly Agree*
I am using only one vendor to support all deposit and loan core processing, trust, digital banking, and commercial lending.	3.37	0.63	*Strongly Agree*
I fail to maintain adequate control of accounts receivable	2.84	0.79	*Agree*
I should allocate my assets across a range of stocks, bonds, and other investments to avoid excessive damage to my portfolio should one of those assets have a considerable decline in value.	3.31	0.54	*Strongly Agree*
I rely on the same upstream vendor or supplier, which could be a point of failure.	3.25	0.68	*Strongly Agree*
Average	***3.22***	***0.41***	***Agree***

The table illustrates the perceived concentration risk associated with microfinance loans. Respondents generally agree (3.22) that microfinance loans carry concentration risk, suggesting a reliance on a single vendor for various banking functions, deposit and loan core processing, trust, digital banking, and commercial lending. Concentration risk, as defined by Grippa and Gornick (2016), is a notable feature in many banking sectors, especially in emerging and small economies.

Table 5 Perceived Credit Risk of Microfinance Loan

	Mean	Standard Deviation	Description
Default Risk	3.46	0.51	*Strongly Agree*
Credit Spread Risk	3.58	0.27	*Strongly Agree*
Downgrade Risk	3.20	0.32	*Agree*
Concentration Risk	3.22	0.41	*Agree*

The table presents perceived credit risks associated with microfinance loans. Respondents strongly agree that microfinance loans carry default risk (3.46) and credit spread risk (3.58). They also agree on the presence of downgrade risk (3.20) and concentration risk (3.22). Assessing entrepreneurs' commitment is challenging due to limited and complex information, potentially increasing bank risks. Prioritizing credit management is advisable. Nduta's 2013 study linked credit management variables (client appraisal and credit risk management) to financial performance indicators like capital adequacy, profitability, and liquidity using a correlation model. Credit risk, defined by Chen and Pan (2012), results from changes in debt instruments and derivatives due to shifts in borrowers' credit quality. Credit risk management mitigates bank risk and assesses its impact on profitability (Kargi, 2011).

Conclusion

Microfinance holds the promise of surmounting these challenges by offering a means for low-income households to stabilize their finances and set aside funds for future necessities. During periods of economic prosperity, microfinance contributes to the growth of families and small enterprises, while during economic downturns, it serves as a vital resource for coping and recovery. The microfinance sector faces particular credit risk challenges due to limited credit data availability and the absence of credit bureaus in many nations. This credit risk is further compounded by the prevalence of over-indebtedness among microfinance borrowers. Most micro-borrowers have meager incomes and minimal to no credit history, making risk assessment a complex endeavor. Over time, the microfinance sector has employed strategies like group lending models and the acceptance of specific types of collateral to mitigate risks associated with microloans.

Furthermore, microfinance institutions (MFIs) have expanded their lending to micro-enterprises based on cash flows. In light of these considerations, MFIs must possess the capability to evaluate the risk linked to microfinance loans. The study's findings suggest that an individual's perception of credit risk in microfinance loans remains consistent across various demographics, including age, business type, utilization of microfinance loans, and loan experience. It underscores the notion that factors beyond these demographics likely influence an individual's perception of credit risk in microfinance loans.

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