
# Assessing the effect of interest rate on loan repayment in community banks in Sierra Leone. Case Study: Yoni Community Bank, Tonkolili District

**Saidu Ibrahim Kuyateh** [1*], **Ibrahim Abass Kamara** [2]

[1-2] Ernest Bai Koroma University of Science and Technology, Faculty of Social and Management Sciences, Makeni, Sierra Leone

* Corresponding Author: **Saidu Ibrahim Kuyateh**

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**Abstract**

The research was carried out to study the effect of interest rates charge on loan repayment in community banks with specific regard to Yoni Community Bank, and the following objectives was derived to arrive at the main aim of the study and these objectives are follows, to look at the effect of interest rate ceiling on loan repayment in Yoni Community Bank, to evaluate the impact of interest rates fluctuation (rising and falling interest rates) on loan repayment in Yoni Community Bank and to analyzing the effects of interest rate on the supply of loans. The study established that most Yoni Community Bank customers were aware of the influence interest rates have on loans in regard to business performance. It was established that the provision of loans to customers has a great impact on their businesses performance. This partly explains unenthusiastic regard of the management of Yoni Community Bank to their improvements, in the credit terms to their client’s entrepreneurs. The study also established the most important cause of poor business performance and collapse as being amongst others the high interest rates, limited amount lent, lack of entrepreneurship skills and high taxes. The researcher recommends that management of Yoni Community Bank should endeavour to conduct some entrepreneurship skills and loan servicing short training workshops if it’s to meet its objectives. It should also revise its terms of lending and reduce on the interest rates to enable entrepreneurs make profits and be able to service their loans as this will lead to the growth and continuity of their businesses.

**Keywords:** Interest rate, Community Banks, Loan Repayment

## 1. Introduction

Banks and other financial institutions are in business to make profit. Financial institutions across the country are following increasingly differentiated pricing strategies aimed at maximizing profits since this is the ultimate goal of any business organization. These strategies are more or less dependent on the Bank of Sierra Leone’s Monetary Policy Committee (MPC) directives regarding inflationary trends and lending rates. In their bid to attract customers, increase market shares and to stay competitive as well as operate within the ambiance of laws governing banking. Banks in Sierra Leone then come out with attractive products and services such as giving of loans that intend to attract the customers (borrowers) and charge certain fees and commissions as interest for the money loan. Lending rates are the charges made to borrowers when they take loans from the bank. The Lending rate affects or impacts on customers (borrowers) and the banks differently. Bank customers, investors, government and all those affected by lending rates and the banks themselves will always reacted varied to changes in, fees and commissions (interest rates) on borrowing.

Interest rates can be classified as either short-term or long-term. For example, you can take out a home loan with the interest rate fixed for 10-20 years. This is considered as a long-term loan. You make the same payments over these years, regardless of whether interest rates rise or fall. Alternatively, when you use your credit card or take out a personal loan you are borrowing money at an interest rate that can change in the short term. As a general rule, short-term interest rates tend to be higher than long-term interest rates. The study seeks to look into the effect of interest rate on loan repayment in community banks.

## 1.1 Background of the Study

Traditional finance theory argues that as the size of a loan expands, the interest rate on that loan rises to accommodate the increased risk associated with the loan. However, utilizing firm-level data banking industry, it is observed that the smaller the loan's size, the greater the interest rate applied, and vice versa. Yet, using a fixed effect panel data framework, this work also shows that the interest rate differences among loan sizes can be mainly explained by the borrower's characteristics for local banks while for foreign banks, its operating characteristics are the most important factors.

Pandey (2010) [16] in his study on financial management in India opined that financial institutions and other MFIs are required to develop a credit policy to govern their operations. In the same light, the author noted that, given that financial institutions and MFIs obtain their revenue from interest accruing from advancing credit facilities to low-income persons, the loan repayment may be uncertain. Also, Ditcher (2003) [6] in his study advised that the success of lending out finances is based on an extensive appraisal of the risk of extending such facilities and also the characteristics of the borrower. It is lamented that lending decisions by all these financial institutions are more often than not based on the subjective feelings regarding risk in relation to repayment by the borrower. The MFIs in its justification of employing this appraisal is that it is both simple and inexpensive (Horne, 2007).

Interest rate is the rent paid on borrowed money. Lenders receive interest as compensation for foregoing the use of their funds now. The original amount rent is called the principal sum and the percentage of principal which is payable over a period of time is the interest. Ivey (2002) [9] and Heaton (2002) [7]. In money monetary using economies, money creates claims because it is an asset, a store of value, as well as means of exchange. Therefore, those who lend money expect to be compensated for handling over their claims for period of the loan to those who borrow the money. The compensation is the interest rate expressed as a rate of percentage per annum because it is convenient way of calculating and comparing the cost of borrowing money. Therefore, the interest rate can be defined as the price the lenders expect and borrowers pay for exchanging current claims for greater future claims to goods and services.

According to Saurina (2005) [10], interest rate is a rate which is charged or paid for the use of money. An interest rate is often expressed as an annual percentage of the principal. It is calculated by dividing the amount of interest by the amount of principal. In general, interest rates rise in times of inflation, greater demand for credit, tight money supply, or due to higher reserve requirements for banks. A rise in interest rates for any reason tends to lessen business activity because credit becomes more expensive in the stock market because investors can get better returns from bank deposits or newly issued bonds than from buying shares.

Banks are exposed to adverse movements in interest rates because on average, rates on their long, fixed-term assets are locked in for longer than rates on their liabilities. When the general level of interest rates rises, banks typically experience a loss in economic value because the value of assets decreases more than the value of liabilities.

One important question in that context is the extent to which realized interest rate risk exposure i.e., the gain or loss in a bank's economic capital attributable to movements in interest rates affects bank lending. This question is particularly relevant in the current environment of prolonged low nominal interest rates in which banks have substantially increased their interest risk exposure (Turner, 2013; SNB, 2014, 2015). For instance, findings by Hanson and Stein (2015) suggest that as nominal interest rates declined, banks have rebalanced their asset holdings toward longer maturities to prevent their portfolios' overall yield from decreasing too much.

In Africa, most businesses owners and customers fail to pay the credit they borrow from banks in the first year, this due to high interest rate from bank regulatory authorities. It has been the main objective of majority Africa country's government to achieve high rate of economic growth that would lead to high economic growth and reduce poverty level. This could be achieved through improvement of micro, small and medium enterprises (MSMES) output indicate the ability of an economy to increase and diversify the production of goods and series with stock of capital(equity/debt) and other factors of production within the economy (Idowu, 2010; Akingunola, 2011) [3].

While some argued that higher lending rates can scare away borrowers and other investors, banks also argue that operational cost and cost of providing efficient services are exorbitant and need to recover these costs in order to stay in business. Thus, the total revenue must be greater than the total cost (TR>TC). Bank of Sierra Leone Act 2000 revised in 2019 emphasized that, every bank is supposed to create awareness to the customer on the amount of charges made, either in real values or percentages as well as interest to be debited on borrower's account's 14 days in advance. The full list of charges and lending rates are to be displayed at bank's branch offices or must be provided to customer on demand. Due to the increase in number of banks, there has been a keen competition among banks to gain a proportion of the market share. Yet, it is seen that the extent to which loans are given or demanded by the private sectors or customers highly depends on the rate of interest and thus the risk involve on the repayment is high.

Interest rates are major concern in the banking and lending industry in Sierra Leone. Financial institutions have been accused of charging high interest rates and exploiting the consumers and borrowers. This has led to the establishment of a Banking Act in 2000 and revised in 2019 by the government through the Bank of Sierra Leone whose been charged with the responsibility of protecting the consumers and supersedes all activities of other financial institution across the country. The Act imposes interest rate ceilings on loan finance provided by money lenders/commercial banks. These ceilings are proposed to be linked to the prime rate. Given this, it is not possible for them to charge full-cost recovery interest rates. This research tries to highlight the effects of interest rate charged, on loan repayment. It argues that the biggest cost component of loaning financial institutions is administration costs and not the cost of capital, thus hiking the interest charged on loan to prime rate is illogic.

### 1.2 Statement of the Problem

It is not clear why the Sierra Leone authorities want to actively promote community banking in a small, underdeveloped country like Sierra Leone with an underdeveloped commercial banking system, as opposed to simply focusing on encouraging greater commercial bank branching and increasing the ability of those banks to lend to certain 'neglected' groups. In big countries such as the US, the idea of community banks is to give greater attention to the demand ('needs') of local communities, individuals and businesses. Community banks are expected to channel deposits, obtained mainly from the local community, into loans in the communities involved. The bank officers are also supposedly highly accessible to the community depositors and borrowers and are immersed in the local affairs of their communities. In making decisions on loans, for example, the personal characteristics of the borrowers are likely to be taken into account, including family history. One advantage that is often cited for such banks is that, being small businesses themselves, they understand the needs and constraints of small businesses.

But community banks in a country like the US are large relative to some of the commercial banks in a country like Sierra Leone. Moreover, the commercial banks in Sierra Leone are likely to behave like community banks in extending loans and in their relationships with their communities. It is little wonder that, even in the FSDP, many think that it may be a good idea to encourage commercial banks (among others) to acquire major shareholding in the community banks. In this author's view, in the Sierra Leone context, promoting branch banking by the commercial banks is a more direct way of achieving whatever benefits are seen to ensue from promoting so-called community banks.

However the number of commercial banks and financial institutions in Sierra Leone keep increasing day by day at a very high rate, which has aggravated the competition between government and the private sector for loanable funds. Despite the increased competition especially amongst many commercial banks, interest rates have remained high; for which Yoni Community Bank is not an exception. This has reduced the customers borrowing and loan repayment capacity has led to an increase to the number of loan defaulters. The intent of this study therefore is to examine the effect of interest rates on loan repayment and why customers fail to repay back the loans on time. It is on this backdrop I want to undertake such research to investigate the effect of interest rate on loan repayment in Yoni community bank taking into consideration the conditions surrounding the loan, the environmental factors whether conducive and a lot of other indicators which will reflect in my report.

### 1.3 Research aim and Objectives

The main aim of the study is to investigate the effect of interest rate on loan repayment in Yoni Community Bank.

#### 1.3.1 Objectives of the Study

1. To look into the effect of interest rates ceiling on loan repayment in Community banks with specific reference to Yoni Community Bank.
2. To evaluate the impact of interest rates fluctuations (rising and falling interest rates) on loan repayment in Yoni Community Bank.
3. To analyze the effect of interest rate on the supply of loans.
4. To suggest possible recommendations with regards charging interest rate to customers for sustainability in the financial sector.

### 1.4 Research Questions

The research tends to pose the following questions:

1. What is the effect of interest rates ceiling on loan repayment in community banks?
2. Is it that the impact of interest rates fluctuations has led to the establishment of other financial institutions?
3. How has the effect of interest rates led to the negative supply of loans?

### 1.5 Research Hypothesis

The following hypothesis is formulated to guide the study;

**H01:** Interest rate has an effect on loan repayment in Yoni Community Bank.

**H02:** Interest rate has no effect on loan repayment in Yoni Community Bank.

### 1.6 Scope of the Study

This research tends to cover selected financial institutions within a geographical zone of Mile 91, Yoni chiefdom by looking at the relationship between interest rates and loan repayment with specific reference to the Yoni Community Bank as a case study. The study is guided to look into the effect of interest rate ceiling on loan repayment, impact of interest rate fluctuations which has led to the establishment of other financial institutions and also look into the effect of interest rate led to the negative supply of loans. The analysis of this research work was done to establish these effects.

The researcher employed a case study descriptive design, using a simple random and purposive sampling method to select respondents, interviews and questionnaires were explored in the collection of primary data and analysed using a Statistical Package for Social Sciences (SPSS).

### 1.7 Limitation of the Study

One of the inherent limitations in survey research is the subjectivity of each respondent no matter how carefully written or completely tested; each survey is vulnerable to differing interpretations of the questions. However, the researcher may also face the following challenges:

**Time:** Ample time was required to be able to collect, analyse and present the required information. Although, a sample was used to manage time.

**Finance:** There may also be shortage of finances, since the school doesn't sponsor the project as such may not be able to meet all expenses related with the field study adequately. However, since the study is survey research, the limitation was recognized and accepted.

The other limitations may be; some respondents answering questions as a result of defensiveness, apathy or ignorance on particular aspects. This study was however diverse enough to derive some significant conclusions with regard to the role of interest rates and bank loan recovery within the Yoni Community Bank.

### 1.8 Justification of the Study
The findings of this research were relevant in the following ways:
1. It will provide customers with an understanding of why commercial banks are charging a given interest rate on loans, which in-turn affects their repayment system of those loans.
2. It will explain why despite central bank and commercial banks' effort to revise interest rates, customers still faced challenges in loan repayment.
3. It will give government an insight on how to intervene to reconcile banks and their customers with an aim of giving way to increase loan accessibility by potential customers there by contributing to the growth and development of the country at large.
4. It will also help to identify other areas in the financial sector that require exploratory research in relation to interest rates and/or other areas in banking industry.
5. This study will also be of relevance to other researchers who may want to undertake such or similar study
6. To policy makers who may want to suggest a better way of improving the financial sector and contribute on capacitating the middle level manpower.
7. To Non-Governmental Organisations in the bid to compliment government effort.

### 1.9 Definition of Terms
**Interest Rate:** The interest rate is the amount a lender charges a borrower and is a percentage of the principal-the amount loaned. The interest rate on a loan is typically noted on an annual basis known as the annual percentage rate.

**Loan Repayment:** It is the amount of money that was agreed by the financial institution (lender) to be paid by the borrower over a particular time.

**Interest Rate Ceiling:** An interest rate ceiling is the maximum interest rate permitted in a particular transaction. It is the opposite of an interest rate floor. Financial transactions often include an interest rate ceiling as part of their contractual provisions. For example, they are commonly used in adjustable-rate mortgage agreements.

**Financial Institution:** A financial institution (FI) is a company engaged in the business of dealing with financial and monetary transactions such as deposits, loans, investments, and currency exchange. Financial institutions encompass a broad range of business operations within the financial services sector including banks, trust companies, insurance companies, brokerage firms, and investment dealers.

**Supply of Loan:** It is the rate at which the financial institution (lender) gives loans to borrowers.

**Lending Rate:** Lending rate or interest rate is the amount charged by lenders for a certain period as a percentage of the amount lent or deposited. The total interest on the amount or the principal sum is determined by the duration of time over which the amount is deposited or lent.

## 2. Literature Review
### 2.1 Introduction
This area of the research will present a review of related literature on the topic understudied. It will be divided into sections based on the objectives; the concepts of interest rate and loan repayment, over view of Sierra Leone Financial sector, discussing the effect of fluctuation on interest rate, the effect of interest rate on the loan repayment and the last section will be looking at the effect of interest rates on the supply of loan.

### 2.2 The concept of the interest rates
According to Michael P. Todaro (1992) [15], interest rates is the amount the borrower must pay to the lender over and above the total borrowed expressed as the percentage of the total amount of the funds borrowed. ACCA (2003) [2], explained the interest rates as a measure of the cost for the borrowing. Bank interest rates are rewards expected by the lenders (bank) for the period the borrower spends using the borrowed funds. It is the time value of money for the funds granted to borrowers in a specific period of time.

**Interest rates**
Saurina (2014) [10] defines interest as the amount a borrower pays in addition to the principal of loan to compensate the lender for the use of the money while Interest rates are the expressions of interest as a percentage of the principal. Whereas interest rate is a rate which is charged or paid for the use of money, an interest rate is often expressed as an annual percentage of the principal. It is calculated by dividing the amount of interest by the amount of principal Baxley (2015). In general, interest rates rise in times of inflation, greater demand for credit, tight money supply, or due to higher reserve requirements for banks. A rise in interest rates for any reason tends to dampen business activity (because credit becomes more expensive) and the stock market (because investors can get better returns from bank deposits or newly issued bonds than from buying shares). Interest rate as being the rate of interest charged for the amount of money borrowed. Banks or lending institutions usually have general guidelines for the rates they intend to charge. Money borrowed on short term basis and long term basis have different rates and the difference between the amount borrowed and the additional amount of money returned is what determines the profit.

### 2.2.1 Types of the interest
David C. (1990) categorizes the interest rate as the bank base rates, personal loan rates, deposit rate, interbank interest rates, house purchase loan rates and the overall level of interest rates while Wikipedia Articles (2007) categorized interest rates as simple interest rates, compound, cumulative and real interest rates.
According to (APPS 1991) [1], interest rates are regarded as purely monetary phenomenon, a payment for the use of money. The possession of the actual money wills our disquietude and the premium which we require to make us part with the money is the measure of the degree of our disquietude. By the way of contract, this theory emphasizes the supply and demand for money, arguing that it is the interaction of variables which determines the interest rates. It stated that the classical theory focuses on what might be termed as the economic variables and argues that the level of real interest rates is determined by the level of savings (which

provides the level of loanable funds) and the level of investment in the capital equipment (which provides the demand for the loanable funds). This theory dismisses the relevance for the money, arguing that its use is to merely determine the absolute price level and does not influence the interest rate.

### 2.2.2 Why interest rates are put in place

According to Kithinji and Waweru (2013) interest can be thought of as "rent of money." Interest rate as a price of money reflects market information regarding expected change in the purchasing power of money or future inflation (Ngugi, 2011). The interest rate on loan rises to accommodate the increased risk associated with the loan. However, utilizing firm-level data of the Barbadian banking industry, it is observed that the smaller the loan's size, the greater the interest rate applied, and vice versa. Yet, using a fixed effect panel data framework, this article also shows that the interest rate differences among loan sizes can be mainly explained by the borrowers' characteristics for local banks while for foreign banks, its operating characteristics are the most important factors (Ngugi, 2011).

### 2.2.3 Dangers of having high interest rates

When interest rate rises up, businesses have to pay more for borrowing. In other words, their cost of taking loan increases which decreases their profitability and due to decrease in profitability market price of their share also decline. Moreover, a rise in interest rate also decreases the worth of corporate bond. The interest rate that a bond pays to its holder is not much attractive due to high interest rate (Accaglobal.com). For borrowing and saving there are various types of interest rates that bank offers. To set the rate of interest that influence the lively of financial system, central bank plays a significant role.

The central bank executes that job by controlling the loan rate for interbank. Because it considerably influences the interest rates for loan and savings that commercial banks offer (Mannasoo, 2012). The main source of commercial bank's income is the interest income by interest rate which is to some extent below or above the inter-bank loan rate. Typically, central bank boosts up the rate of interest for many causes that may or may not correct the intended issue. Inflation is from one of them. Rising interest rate encourages the people to keep their funds with bank by offering hand sum saving interest income. Rising interest rate and over spending cause stress on inflation. While on the other hand, when interest rate goes up make borrowing more expensive which results into fall in mortgage and investment.

### 2.3 The Concepts of loan repayment

Loan borrowing: A loan is the act of giving money, property or other material goods to a party in exchange for future repayment of the principal amount along with interest or other finance charges. A loan may be for a specific, one-time amount or can be available as open-ended credit up to a specified ceiling amount (Kwangwoo, 2010). Lending is the principal business activity for most commercial banks. The loan portfolio is typically, the largest asset and the predominate source of revenue. As such, it is one of the greatest sources of risk to a bank's safety and soundness. The level of interest risk attributed to the bank's lending activities depends on the composition of its loan portfolio and the degree to which the terms of its loans (maturity, rate structure, and embedded options) expose the bank's revenue stream to changes in rates (Pennacchi 2011).

Johnson, S (2013) proposed that loans such as payday loans and money advances can greatly help the public to tide over their bills before payday so as to increase on their monthly budget. Due to the financial crisis, the cash crunch has become real for many people in the world today. Barajas, A, & Salazar, N. (2012). Payday loan usage has soared as the key way to help people sort out a few payments while they are waiting for their pay to come through though, relying on loans every month is not a good idea and payday loans and money advances should only be used in the short-term when a pressing financial need comes up.

According to Arano, K (2009), the public borrows loans in order to purchase motor vehicles since the motor industry is known for the sky-high prices of cars as well as the car finance industry. If someone needs a car but you don't have the cash on hand to buy a car, you can apply for a car finance loans. These tend to come from car finance companies. Car finance loans are expensive though so it is important to be in full-time and steady employment before you apply for a loan. Since getting a mortgage is one of the most lives changing moments in someone's life, the public borrows loans in order to be able to buy a house. The ability to get on the property ladder is something that many Brits aspire to. If you want to buy a home, your best bet is to improve your personal finances and apply for a mortgage with a bank or building society that understands your needs well (Bazibu, M. 2009). You also need to save for a deposit which can take time, so it is important to start managing your credit profile well. Personal loans used to be popular options for people who wanted to do extensions on their homes or renovations. Personal loans can be used for any personal reason as long as your lender approves of that. Mojon, B. (2011) proposed that it can be hard to resist the temptation of getting your children something that they have wanted for a long time.

### 2.4 Overview of Financial Sector in Sierra Leone

The financial sector in Sierra Leone is one of the shallowest in the region, and has been declining. Credit to the private sector declined from 7.5 percent of GDP in 2011 to 5.8 in 2016 and to 5.1 in 2017. The major driver of this has been increased lending from the banking sector to the central government, which increased from 5.5 percent in 2011 to 16.18 in 2016 and 17.6 percent in 2017.

The banking sector is dominated by commercial banks in Sierra Leone it includes; 14 commercial banks, 17 community banks 59 financial services associations (FSA), 13 MFIs (2 deposit taking and 11 credit only), and three mobile money operators. The commercial banking sector accounts for 99 percent of all financial sector assets. There are 11 foreign banks, two state owned banks, and one domestic bank. Total assets of the commercial banking sector are Le5.29trillion, and account for over 99% of the assets in the financial system. The 11 foreign banks account for most than 60% of the industry's total assets.

The 17 community banks, 59 FSAs, 2 deposit taking and 12 credits only MFIs are the primary branch based financial service providers in rural areas. Community banks, FSAs, and MFIs primarily cater to micro and small entrepreneurs and enterprises. These institutions also have a significant focus on agricultural lending and on rural areas and they also focused on giving out loans to their customers.

### 2.5 Effect of interest rates and Interest Rate Ceilings on loan repayment

The level of interest rates has a direct effect on a consumer's ability to repay a loan. For example, Thordsen and Nathan (1999) [20], assert that when interest rates are low, people are willing to borrow because they find it relatively easy to repay their debt. When interest rates are high, people are reluctant to borrow because repayments on loans cost more. Some consumers may even find it difficult to meet their existing loan repayments, especially if interest rates increase faster than the rise in a consumer's income. If interest rates rise sharply and stay high for a long period, some consumers will default on their loans.

When the Government regulates the working of the market, supply and demand cannot interact freely to find the equilibrium quantity and price. When there is an artificial ceiling the allocation of resources is distorted if the equilibrium price is above the ceiling. The consequence is people who want finance, but due to their circumstances do not qualify at the ceiling interest rate are denied access. As this large segment of the market cannot access funds in the formal economy they have to resort to the informal economy. By limiting the interest rate chargeable, the government may force many actors in this sector out of business existence. By placing a ceiling on the interest rate, but not providing an alternative means of finance, the government effectively excludes the people they were trying to protect. And, since interest rates are not allowed to rise above a given price, there are no incentives to expand the quantity of loans offered and this will create a shortage.

#### 2.5.1 Effects of Interest Rate Fluctuations (Rising and Falling Interest Rates)

One factor that influences the level of interest rates in Sierra Leone is the actions of the Central Bank. In trying to avoid massive swings in the business cycle, the Bank of Sierra Leone (BSL) will adjust short-term interest rates. It raises interest rates to slow down an economy that is expanding too rapidly and lowers them when the economy is heading for a recession. Rising and falling interest rates will directly affect consumer and personal financial decisions. Rising interest rates make saving relatively more attractive and borrowing relatively more expensive. Falling interest rates have the opposite effect. Consequently, the effect of an interest rate rise or fall will depend on whether you are a saver or a borrower.

**However, below are the factors influencing the fluctuations of Interest Rate in Commercial Banks in Sierra Leone?**

- **Inflation**

Inflation refers to the rate at which the general level of prices for goods and services is rising and, consequently, the purchasing power of currency is falling. Central banks attempt to limit inflation, and avoid deflation, in order to keeps the economy running smoothly or it is a general increase in prices and fall in the purchasing value of money. The rate of inflation is another important factor that governs interest rates on borrowing in commercial banks. The lenders prefer lending at interest rates that are higher than the rate of inflation. Otherwise, they will post a negative growth in absolute terms. Therefore, a rise in the rate of inflation signals a higher interest rate regime. On the other hand, a drop in the rate of inflation indicates a softer interest rate regime. Over time, as the cost of products and services increase, the value for money decreases. Consumers will therefore have to spend more money for the same product or services which had cost less in the previous year. As for finance lending sector, borrowers may find it attractive to borrow now but less attractive to lender (Piazza 2007). The value for money now has fallen as compared to the time when they lent their money. In order to compensate this loss, lenders have to increase the interest rate, falling in value and they are easily converted into other goods.

- **Supply and Demand**

Supply, refers to an amount of something that is provided or available to be used, while demand refers to the desire backed by ability and willingness to acquire something by someone. Interest rate levels are a factor of the supply and demand of credit: an increase in the demand for credit will raise interest rates, while a decrease in the demand for credit will decrease them. Conversely, an increase in the supply of credit will reduce interest rates while a decrease in the supply of credit will increase them. The supply of credit is increased by an increase in the amount of money made available to borrowers. For example, when you open a bank account, you are actually lending money to the bank. Depending on the kind of account you open (a certificate of deposit will render a higher interest rate than a checking account, with which you have the ability to access the funds at any time), the bank can use that money for its business and investment activities. In other words, the bank can lend out that money to other customers. The more banks can lend, the more credit is available to the economy. And as the supply of credit increases, the price of borrowing (interest) decreases (Petersen, 2010).

- **Profitability and Efficiency**

Upton and Wheelwright. Wiley, (2009), defines Profitability as the ability of a business to earn a profit. A profit is what is left of the revenue a business generates after it pays all expenses directly related to the generation of the revenue, such as producing a product, and other expenses related to the conduct of the business activities: The state or condition of yielding a financial profit or gain. It is often measured by price to earnings ratio profitability. According to Hilda (2011), Banks' profitability and efficiency are often considered as the main factors that influence interest rates and interest rate spreads. The continuous trend of expanding bank activities in recent years, as well as the reallocation of low-interest-bearing assets into high-interest-bearing assets, had a direct positive impact on the improvement of banks' profitability and efficiency. However, the trend of continuous improvement in banks 'profitability and efficiency was interrupted in 2008, when profits were 6.6% lower than in 2007. In addition, banks' profits were four times lower in the first half of 2009 compared to the same period in 2008. (Shijaku, Hilda and Kliti Ceca. 2011).

- **Loan amount**

A loan is defined as the act of giving money, property or other material goods to a party in exchange for future repayment of the principal amount along with interest or other finance charges. (Guttentag, Jack. 2010). A loan may be for a specific, one-time amount or can be available as open-ended credit up to a specified ceiling amount. Baxley (2013) noted that a loan is the money borrowed by a client from the bank and it is the principal business activity for most commercial banks. The loan portfolio is typically the largest asset and the predominate source of revenue. As such, it is one of the greatest sources of risk to a bank's safety and soundness. Whether due to lax credit standards, poor portfolio risk management, or weakness in the economy, loan portfolio problems have historically been the major cause of bank losses and failures. Effective management of the loan portfolio and the credit function is fundamental to a bank's safety and soundness. Piana (2012) states that the interest rate is the profit over time due to financial instruments. In a loan structure whatsoever, the interest rate is the difference (in percentage) between money paid back and money got earlier, keeping into account the amount of time that elapsed.

- **Economy**

According to Perry and Romney. T, 2011, an economy is an area of the production, distribution, or trade, and consumption of goods and services by different agents in a given geographical location. Understood in its broadest sense, 'The economic is defined as a social domain that emphasizes the practices, discourses, and material expressions associated with the production, use and management of resources'~ Economic agents can be individuals, businesses, organizations, or governments. Therefore, the general conditions are among the prime factors that influence the movement of interest rates. In a growing economy like Sierra Leone, people have secure sources of earnings and hence high confidence levels to borrow and buy. For example; people go in for a house, a car, consumer appliances, etc. This increases the demand for funds. Hence, it influences the rate of interest in an upward direction. In a necessary economic condition or slowdown, the interest rates tend to go down due to the opposite happening.

### 2.5.2 The Effects of an Interest Rate on the Supply of loans

Basically, this will encourage people to consume more of the service than if the market price were charged. One of the key factors influencing the lack of supply of credit to small enterprises is the non-recoverability of costs. Charging a rate of interest on loan is the main source of income for almost all financial institutions in the banking industry. It is the only way by which they can recover their costs. The components of an interest rate in most loans includes, Cost of capital, Sufficient return to cover the risk of loan loss or bad debt, Operating costs and a profit margin. Given these, the banking or lending institutions can only survive by fully recovering all the costs of the first three components, and grow if they can also receive the last component.

## 3. Presentation and Analysis of Findings

### 3.1 Introduction

This chapter presents the research findings, analysis and interpretation in accordance to the study objectives. The data presented in this chapter is based on a sample survey carried out within Yoni Community Bank's customers Mile 91, Yoni Mamalla Chiefdom, Tonkolili district. Out of the sample population of 60 respondents, 10 were bank officials that are selected within Yoni Community Bank and 50 were bank customers. Descriptive statistics have been used to analyse data and frequencies and percentages have been summarized in tables. Data is analysed in two approaches, the first one look at the demographic background of the respondents and the second part of the analysis, analysed data based on the research important information relating to the topic and the research objectives.

### 3.2. Respondents Rate

From the collection of questionnaires, out of the 60 questionnaires presented to respondents, they all response positively since they were well informed and knowledgeable over the study topic. This put the respondents' rate to 100%.

### 3.2.1 Interest Rate Ceilings on Loan Repayment.

The first objective of the study was to look on the effect of interest rate ceiling on loan repayment, in Yoni Community Bank. Data collected presented as below.

**Table 1**

| Response | Frequency | Percentage (%) |
|---|---|---|
| Agree | 30 | 50 |
| Strongly Agree | 13 | 22 |
| Disagree | 12 | 20 |
| Strongly Disagree | 5 | 8 |
| **Total** | **60** | **100** |

**Source:** Table 1 Authors on Construct 2021 based on data available.

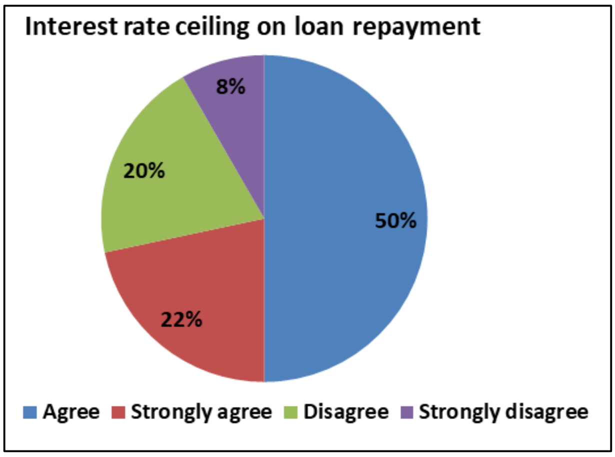


**Fig 1:** Pie Chart Showing Interest Rate Ceilings on Loan Repayment

According to table 3.2.1 above, 12 respondents of the study that representing 20% of the sample population for the study they are aware about the interest rate ceiling on loan in Yoni Community Bank, and they further disagree that the interest rate ceiling on loans in Yoni Community Bank is satisfactory as compare to other financial institution while, 5 respondents that representing 8% of the respondents were strongly aware on the interest rate ceiling, and they also strongly disagree that the interest rate ceiling is acceptable and satisfactory. On the other hand, 30 respondents of the study representing 50% of the sample population, were totally agree that the interest rate ceiling is high and they also aware about the interest rate ceiling on loans in Yoni Community Bank. According to them, the interest rate ceiling on loans in Yoni Community Bank is very high in which the management of Yoni Community Bank will have to reconsider although their main aim is to maximize profit but also it is a community bank that was established with the aim of promoting the human capital in the community through by the provision of loans to the needy in order for them to embark on trading, and farming that they will use as a source of sustainability for their family and also repaying their loans on the slated time. 22% of the respondents strongly aware and agree that the interest rate ceiling on loans in Yoni Community Bank is very high and with that its will lead to loan defaulters and also cause the demand for loans to also decrease as a result of the high interest rate charge they further say that if nothing to be done on the issue of the high interest rate charge on loans, it will might affects their customer base.

Basing on these study findings, it was found out that though some customers have had their enterprises achieve some levels of growth, virtually all respondents complained about high interest rate and proved its effect on their repayment of loans. It was further find out that many of these loan customers have pulled out using loans any more while others are planning to stop seeking for loans once their current running loans are fully repaid if, the bank does not revise its interest charged on loans.

According to the responds of the Yoni Community Bank officer in the loan department, the interest rate ceiling on loans is not determined by them, it is determine by the central bank in which they are just operating on instructions and they have no power to change the interest rate ceiling that was slated by the central bank because it is a policy they further said that, they do not agree to this statement that interest rate ceiling charge on loan is high because looking at other financial institution their interest rate is very high as compare to theirs and they continue saying that out of the financial institutions in Tonkolili district, they have the lowest interest rate charge on loans because they are working on the interest of the people.

### 3.2.2 Interest Rate Fluctuations on Loan Repayment

**Table 2**

| Response | Frequency | Percentage (%) |
|---|---|---|
| Agree | 38 | 63 |
| Strongly Agree | 12 | 20 |
| Disagree | 6 | 10 |
| Strongly Disagree | 4 | 7 |
| **TOTAL** | **60** | **100** |

**Source:** Table 2 Authors on Construct 2021 based on data available.

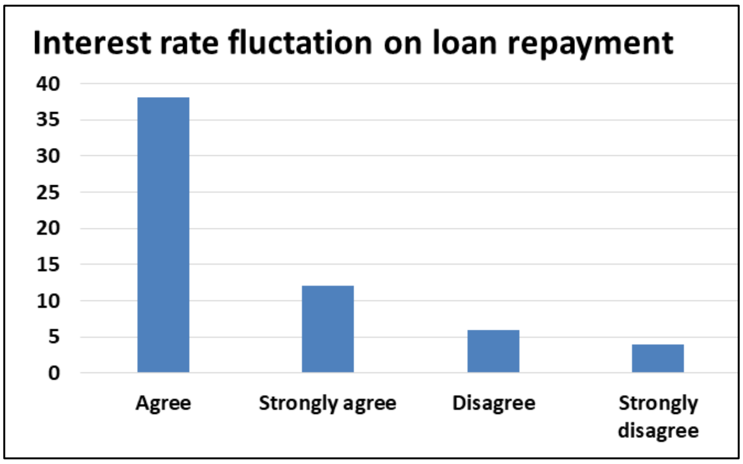


**Fig 2:** Interest Rate Fluctuations on Loan Repayment

In table 3.2.2 above 63% of the respondents are with the agreement that the interest rate charged on loans by the Yoni Community Bank is not static in which they do not aware about the causes of fluctuation in the level of interest rate charge on loans they further said that when there is an increase in the level of interest rate charge on loans they will be informed by the bank officials, 12 respondents which representing 20% of the sample population strongly believe/agree that the interest rate charge on loans do fluctuate but it is not that frequent while 6 respondents of the study representing 10% of the selected population said that there is no fluctuation on the interest rate charge on loans, and 7% of the population that makes up to a frequency of 4 strongly disagree there will be no fluctuation in the level of interest rate charge on loans.

According to the responds of the bank officials of Yoni Community Bank, they agree to the fact that indeed interest rate charge on loans do fluctuate and they also give causes that leads to the fluctuation of interest rate charge on loans one of the causes they slated is Inflation rate. According to them, when the inflation rate of the country increases the interest rate charge on loans will also increase in order to meet on their day to day expenses of the institution while when the inflation rate of the country decrease the interest rate charge on loans will also decrease. And other cause is the demand for loan, according to them when the demand for loan decrease the management will decrease the interest rate charge on loans in order to attract customers coming for loan while when the demand for loan increase the management will increase the interest rate charge on loans in order to discouraging customers demanding for loan because when there is much money circulation in the country it will cause demand pull inflation that is lot of customers chasing few goods in the market.

### 3.2.3 Effect of Interest Rate on Loan Repayment

**Table 3**

| Response | Frequency | Percentage (%) |
|---|---|---|
| Agree | 42 | 70 |
| Strongly Agree | 11 | 18 |

| | | |
|---|---|---|
| Disagree | 5 | 8 |
| Strongly Disagree | 2 | 4 |
| **Total** | **60** | **100** |

**Source:** Table 3 Authors on Construct 2021 based on data available.

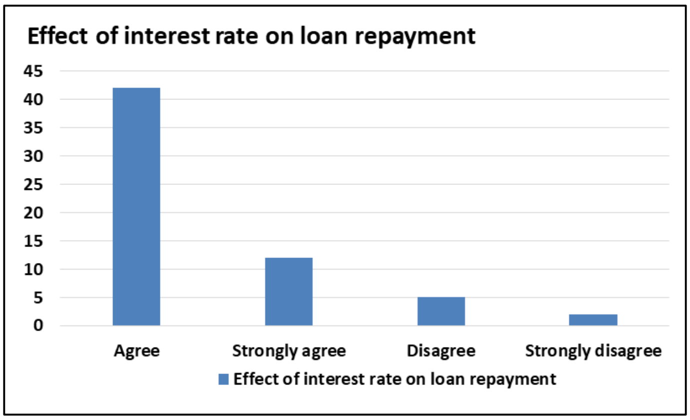


**Fig 3:** Effect of Interest Rate on Loan Repayment

From the table above, 70% of the respondents with a frequency of 42 attests to the fact that when there is an increase in the level of interest rate charged on loans, this will negatively affect their business because when the interest rate charge on loans increases lending capacity will decrease and with that, it will affect their purchasing power since they do not have the required amount they normally used to pay for commodities thus it will affect their business profitability. 5 respondents which representing 8% of the population disagree that a change in the interest rate charge on loans do not have any relation to the increase or decrease of their business activities or business profitability, because it is an agreement between the two parties involve that is, you the customer and the bank officials. However, 4% of the respondents say that an increase in interest rate does not have no effect in the repayment of loan.

According to the views of the bank officials, when there is an increase in the level of interest rate charge on loans, the demand and supply of loans will decrease and it will negatively affect the growth of the institution because the higher the demand of loans the more profit the institutionwill ascertain. On the other hand, when the level of interest rate charge on loans decrease the demand for loan will also increase that is when the management decided to reduce the interest rate charge on loans, more customers will go in for loan as a result of the decrease in the level of interest rate charge on loan and with that, the supply of loans by the bank will also increase. In the economics point of view it illustrates that the higher the price, the lower the quantity of the commodity will be demanded, and the lower the price the higher the quantity of the commodity will be demanded.

### 3.2.4 Proposed Factors Leading to Loan Defaults

**Table 4**

| Response | Frequency | Percentage (%) |
|---|---|---|
| Higher Interest Rate | 29 | 58 |
| Short Repayment | 5 | 8.3 |
| Fiscal/monetary Policy | 9 | 15 |
| Social/Domestic Problems | 3 | 5 |
| Lack of entrepreneur skills | 14 | 23.3 |
| **Total** | **60** | **99.6 = 100** |

**Source:** Table 4 Authors on Construct 2021 based on data available.

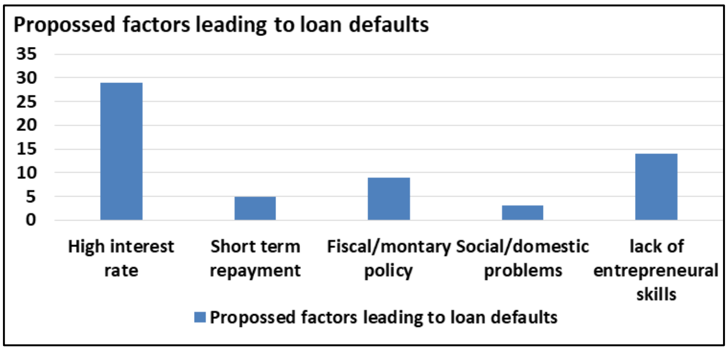


**Fig 4:** Proposed Factors Leading to Loan Defaults

From Table 3.2.4, results of loan problems affecting loan repayment in Yoni Community Bank were analysed. The researcher analysed respondents' views on some limitations that affect loan repayment such as high interest rates, short term repayment period, the government monetary/fiscal policy, remuneration, size of capital (loan), social problems, lack entrepreneurial/business skills. From the above table, interest rates and small loans offered featured more frequently. Respondents in this research who criticized the high interest rate and lack of entrepreneurship skills as factors behind loan repayment defaults and affecting their business growth and performance accounted to 48% and 23.3% respectively of the total number of respondents and this was followed by those who criticized the fiscal/monetary policy of loans offered (15%). Criticisms against short repayment period were 8.3% and social problems/domestic problems experienced with the business owners were 5%.

### 3.3 Analysis of Loan Repayment and Interest Rate

### 3.3.1 Interest Rate Charge

**Table 4**

| Response | Frequency | Percentage (%) |
|---|---|---|
| Agree | 35 | 58 |
| Strongly Agree | 11 | 18 |
| Disagree | 4 | 7 |
| Strongly Disagree | 10 | 17 |
| **Total** | **60** | **100** |

***Source***: Table 5 Authors on Construct 2021 based on data available.

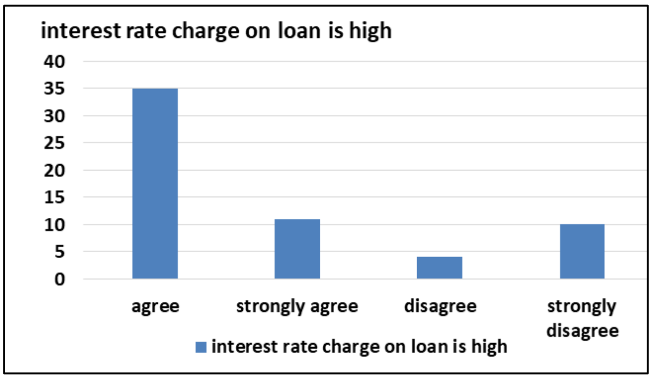


**Fig 5:** Interest Rate Charge

In table 5 responses were given towards the statement that "Does interest rate charged by Yoni Community Bank is high?" from the analysis above, 58% of the respondents attested to the fact that indeed the interest rate charge on loans in Yoni Community Bank is high, according to them, the other financial institution provide a friendly interest rate to their customer as compare to them. 10 respondents of the study which represent 17% totally disagree that interest rate charge on loans is not high, according to them, the interest rate is known to them and it is an agreement between two parties if you agree then the loan will be given to the customers.

According to the views of the bank officials of Yoni Community Bank, there are three types of loans issue to customers and each of these loans has it on interest rate charge. They are follows: commercial loan, agricultural loan, and salary loan.

According to them, Commercial Loans are loan given to customers and the interest rate charge for it is 25%. Agricultural Loans, are loans given to farmers and it interest rate charge is 20% while for Salary Loans, are loans given to teachers police etc. and it interest rate charge is 30%. According to them, the interest rate is charge base on the facility provided to customer, they further said that, those that are having short term repayment period have to pay high interest rate as compare to those that are having long term repayment period.

### 3.3.2 Loan Repayment Process

**Table 6**

| Response | Frequency | Percentage (%) |
|---|---|---|
| Agree | 2 | 3 |
| Strongly Agree | 3 | 5 |
| Disagree | 7 | 12 |
| Strongly Disagree | 48 | 80 |
| **Total** | **60** | **100** |

***Source***: Table 6 Authors on Construct 2021 based on data available.

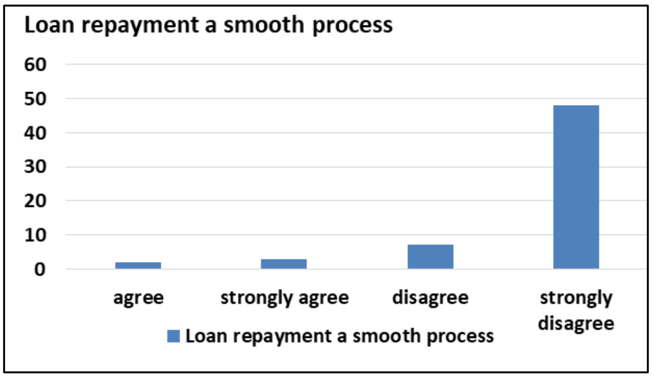


**Fig 6:** Loan Repayment Process

Table 6 from the analysis above, 48 of the respondents which represent 80% of the total population were in total disagreement that Loan Repayment is never a smooth process according to their responds, during the time of loan application there is a provision for collateral that is if you are not able to pay the loan on time the property given to them as a means of recovering their money and there is also a provision for a guarantor that is a person that will stand on your behalf if the customer is not able to pay the loan or died in the process of paying the loan that guarantor will going to pay that loan. and 3-2 respondents of the study that make up to 5% and 3% respectively totally agree to the statement that, Loan Repayment is a smooth process.

## 4. Summary of Findings, Conclusion and Recommendations

### 4.1 Introduction

Under this chapter, the researcher summarized the study findings, based on the findings discovered he drawn conclusion and makes recommendations in accordance with the study objectives. As the main aim of the study is the "Effect of Interest Rate on Loan Repayment".

### 4.2 Summary Findings

This chapter is a reflection of the earlier discussions. The main objective of the study was to examine the effect of interest rates on loan repayment, a case study of Yoni Community Bank, Tonkolili District. The specific objectives of the study were; to look in to the effect of interest ceiling on loan repayment, to evaluate the impact of interest rates fluctuation on loan repayment and to analyse the effects of interest rate on the supply of loans. Existing literature on the subject under study was reviewed. The study used questionnaires and interviews as data collection instruments/methods.

This study mainly focused on the impact of interest rates on loan repayment in Yoni Community Bank. The study examined the level of interest rate in Yoni Community Bank, loan repayment and recovery. The study was virtually of qualitative design, however, it comprised of some quantitative aspects/data. Primary data was got from a cross section of the bank customers and staff of Yoni Community Bank. Documentary review, structured and semi-structured questionnaires and in-depth interview were the techniques used to collect data.

The research, therefore, hoped to establish the relevance of some of the theories of loan repayment and performance in the business sector and the effect of interest rates on performance of small business in Yoni Chiefdom. To a large extent, the importance of loans developing enterprises was examined and its relationships to the dynamics business growth and development were established. Further, the different factors affecting the loan repayment were also assessed.

The methodology constituted the use of a cross-sectional study design. The purpose of this choice of research design was to enable the researcher get an in-depth description of the performance factors relating to loans and how they affect business performance.

The study took a sample of 60 respondents of which 10 were the bank officials and 50 are customers of the bank, from which data was collected using both a questionnaire and interview method. The respondents' rate is 100% this is because the respondents were well informed and have a great knowledge over the study topic. 62% of them are male and 38% are female. The study shows that 33% of the respondents are within the age bracket 30-39 years. Moreover, the study shows that all the respondents acquired tertiary education even though others are with certificate or diploma. 37% of them are married.

From the study, 50% of the respondents have the total conviction and agreed that loans have helped their business grow and 20% disagree that loans advanced to them by the bank did not help their business to grow this is because many of them accused the bank of charging high interest rate which they claimed might affect their repayment capacity over time if the terms and conditions are not revised.

Basing on the fact that though customers see their enterprise achieved some level of growth, inversely all the customers in the bank raised concern about the interest rate to be high and thus its provides negative effect on the repayment of loans given to them. The study also find out that many of the customers have decided not to use loans no more and others are deciding to stop taking loans once their current loans are fully repaid, if the terms and conditions regarding interest rate are not revised.

Again, 63% of the respondent agreed with the fact that the interest rate charged on loans by Yoni Community Bank is not static and hence keep fluctuating overtime. This dynamics of interest rate fluctuation by the Yoni Community Bank is not a problem caused by them according to the bank officials of Yoni Community Bank, the increase of interest rate charge on loans is influence by the rate of inflation in the country that is, if the rate of inflation in the country increases, the interest rate charge on loans will also increase in the other hand if the rate of inflation in the country decreases the interest rate charge on loans will also decrease thus, it is only one sector that is responsible in regulating interest rate on formal financial institutions which the monetary policy that is influenced by the central bank.

From the study, out of the 100%, 58% of the respondents strongly agreed to the fact that the major factor that causes loan default or not repaying loans on time is the higher interest rate charged on loan by the bank and thus it discourage them from going for loans and the higher interest rate will tends others to tolerate loan default. The customers claimed that other banks provide friendly interest rates on their facilities to their customers whiles 100% from the bank officials that were interview strongly disagree to the statement that the interest rate charge on loans is high, since their main aim is to maximize profit, and they aware the only of their profit maximization is based on the interest rate they charged on their facilities given to their customers and they should always protect their institution no matter what.

Moreover, 70% of the respondents prove that there is a negative effect of interest rate on loan repayment since an increase in interest rate charge on loans will negatively affect the demand for loans by the customers and hence will reduce the customer base of the bank which negatively affect the profit margin of the bank and slow down it growth. Inversely, customers also pointed out that the bank can broaden the customer base if they decrease their interest rate. Since a decrease in interest rate will increase the supply of loans and also enlarged the customers base of the bank which help customers to even have the capacity to repay their loan on time and even increase the profit margin of the bank.

In conclusion, the study clearly shows that there is to great extent a close relationship between interest rates and loan repayment in conjunction with business growth and performance. High interest rates, coupled with lack of entrepreneurial skills were seen as the major factors that have a direct bearing leading with the loan repayment default among customers. Literature available clearly shows that however much loans have great role in business growth and development and therefore performance, the level of interest rates has a significant effect in loan repayment thus one claim that a loan may not necessarily be solely the paramount factor, the self-efficiency theory clearly shows that enterprise growth and performance is dependent on entrepreneurship skills, which in many cases are equally districted to every person therefore giving loans to people who lack skills to effectively and efficiently invest it is a waste of time.

In addition to the above, the entrepreneurs should formulate associations and organize seminars and/or workshops for entrepreneurship skill acquisition and loan investment and servicing. Further, Yoni Community Bank and other Micro Finance Institutions should put a mechanism that will support its clients training programmes and enforce them on how to use and manage loans and their enterprises so as to ensure growth and continuity of their businesses. This will also help them taking up opportunity cost while dealing in business and avoid diversification of funds to non-profitable business ventures like for home consumption and other domestic (social problem solving).

## 4.3 Conclusions

The purpose of the study was to establish the effect of interest rate on loan repayment in Yoni Community Bank, Tonkolili District, Sierra Leone and it was carried out on the three research objectives which included to: look into the effect of interest rates ceiling on loan repayment in Community banks with specific reference to Yoni Community Bank, evaluate the impact of interest rates fluctuations (rising and falling interest rates) on loan repayment in Yoni Community Bank, and analyse the effect of interest rate on the supply of loans.

The findings revealed that though interest rates impact much on loan repayment, still there are other activities need to be put in place at Yoni Community Bank, according to majority58% of the respondents were saying that the interest rate charge on loan is high, while, 10 respondents of the study which represent 17% of the total population totally disagree that interest rate charge on loans is not high also, 70% of the respondents also said that a rise in interest rates for any reason tends to dampen business activity whiles the bank officials said that the interest rate on loan rises to accommodate the increased risk associated with the loan and 8% of the respondents said that an increase in the level of interest rate do not have anything to with the progress of fall of their business activity. 30 respondents of the study representing 50% of the sample population, were totally agree that the interest rate ceiling is high and they also aware about the interest rate ceiling on loans in Yoni Community Bank, while 12 respondents of the study that representing 20% of the sample population for the study they are aware about the interest rate ceiling on loan in Yoni Community Bank, and they further disagree that the interest rate ceiling on loans in Yoni Community Bank is satisfactory. 63% of the respondents are with the agreement that the interest rate charged on loans by the Yoni Community Bank is not static while 6 respondents of the study representing 10% of the selected population said that there is no fluctuation on the interest rate charge on loans.

### 4.4 Recommendations
From the study findings recommendations were sought and different views given on what should be done as measures to overcome the business failure, collapse and/or poor performance of loan repayment in Small and Medium Enterprises in Sierra Leone.
The researcher therefore recommends that Yoni Community Bank should endeavour to conduct some entrepreneurship skills and loan servicing short training workshops in order to meet its objectives.
Furthermore, the researcher recommends that Yoni Community Bank should revise its terms of lending and therefore reduce on the interest rates so as to enable entrepreneurs have room for making profits to enable them service their loans as this will lead to the growth and continuity of their businesses.
In addition to the above, the entrepreneurs should formulate associations and organize seminars and/or workshops for entrepreneurship skill acquisition and loan investment and servicing.
Further, Yoni Community Bank and other MFIs should put a mechanism that will support its clients training programmes and enforce them on how to use and manage loans and their enterprises so as to ensure growth and continuity of their businesses. This will also help them taking up opportunity cost while dealing in business and avoid diversification of funds to non-profitable business ventures like for home consumption and other domestic (social problem solving).
From the study findings recommendations were sought and different views given on what should be done as measures to overcome the business failure, collapse and/or poor performance in Yoni Mamalla Chiefdom. It is proposed that all Community Banks should revise their interest rates to such amount affordable by people at different economic levels. Further suggestions were that things like assessment fees should be abolished completely or reduced so as to enable those intending to access loans facility do so at a reasonable and affordable cost.
In addition to the above, respondents called upon the management of Yoni Community Bank and the government to reduce interest rate charge on loans in small businesses, saying that however much loans are extended to small business enterprises for development and /or boosting of the sector, high interest rate charge cannot allow reasonable profit generation.
Finally the researcher's advice is that entrepreneurs should commit all their efforts and resources to profitable business ventures other than diverting loans for consumption purposes and solving domestic problems if their enterprises are to perform and grow and should endeavour to attend entrepreneurship skills workshops and/or short training programmes.

### 4.5 Areas for Further Research
The study has revealed that for a better understanding of loan scheme and its tenet effect on micro-enterprise performance in the growing global economic sector, other emerging business trends need substantial investigation. The suggested areas are:
- Investigating on the effect of interest rate on the demand and supply of loans.
- Investigating the causes of different interest rate charge on loans in private formal financial institutions and public formal financial institutions
- Nexus between entrepreneurship skills development and business growth in Sierra Leone.

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