# Guarantor's Cheque and Loan Performance of SMEs in Selected Microfinance Banks in Nigeria

**Ohwo Kensington Onajero**

**UCEE Microfinance Bank, Nigeria**

**DOI**: **https://dx.doi.org/10.51584/IJRIAS.2025.10100000161**

**Received: 26 October 2024; Accepted: 02 November 2025; Published: 19 November 2025**

## ABSTRACT

This study examines the effect of guarantors' cheques on the loan performance of Small and Medium Enterprises (SMEs) in selected Microfinance Banks (MFBs) in Lagos, Nigeria. Using a survey research design, data were obtained from 18 Managing Directors of MFBs through a structured questionnaire and analysed using multiple regression analysis. The findings reveal that guarantor cheques, together with control variables such as interest rate, loan size, and demographic characteristics, do not have a statistically significant effect on loan performance. Although guarantor cheques alone exhibit some influence, the result suggests weak enforceability in the Nigerian context due to legal and institutional challenges. The study recommends the adoption of technology-driven guarantees such as the Global Standing Instruction (GSI) to improve loan recovery, strengthen credit risk management, and enhance financial discipline among borrowers and guarantors.

**Keywords:** Guarantor's cheque, loan performance, microfinance banks, SMEs, credit risk 1.

## INTRODUCTION

Microfinance Banks (MFBs) play a crucial role in Nigeria's financial inclusion agenda by providing credit to low-income individuals and SMEs excluded from the formal banking system. Despite their importance, MFBs face persistent challenges with high loan default rates that threaten their sustainability (Afolabi, 2021; Abdulhamid et al., 2023). One common risk management tool is the use of guarantors, often backed by postdated cheques as collateral. These cheques are intended to serve as a form of legal and financial assurance in the event of loan default by the borrower. However, the practical effectiveness of guarantor cheques in ensuring repayment remains questionable. Enforcement difficulties, prolonged legal processes, and weak institutional frameworks have limited their impact. This study, therefore, investigates how guarantors' cheques influence loan performance in MFBs, focusing on SMEs in Lagos State.

The study's primary objective is to evaluate the relationship between guarantor cheques and loan performance, while considering institutional and demographic factors. The findings are expected to guide policymakers and practitioners in designing more reliable credit recovery mechanisms in the Nigerian microfinance sector.

## LITERATURE REVIEW

### 2.1 Theoretical Framework

This study adopts Signaling Theory (Spence, 1973), which posits that individuals and institutions send signals to reduce information asymmetry between parties. In banking, a guarantor's cheque acts as a signal of the borrower's commitment and creditworthiness. However, for a signal to be effective, it must be credible and enforceable (Connelly et al., 2011). In contexts like Nigeria, where the legal enforcement of cheques is weak, the credibility of this signal diminishes, reducing its predictive value for loan repayment.

### 2.2 Conceptual Review

A guarantor is a third party who assumes liability in case of borrower default (Nwikpasi, 2015). In microfinance lending, guarantor cheques are commonly used to assure repayment. Their effectiveness depends on factors such

ISSN No. 2454-6194 | DOI: 10.51584/IJRIAS |Volume X Issue X October 2025

as the guarantor's financial stability and the legal enforceability of the cheque (Akhter, 2023). Orok et al. (2023) argue that frequent cheque rejection or "bouncing" due to insufficient funds often undermines their purpose, leading to reputational damage and legal disputes.

Loan performance, on the other hand, measures the borrower's ability to meet repayment terms. It is influenced by internal factors such as interest rates, loan size, and borrower characteristics, as well as external factors like the economic environment (Umar, 2022). Non-performing loans (NPLs) are a critical measure of loan performance and credit risk management in financial institutions across the world (Nkusu, 2011).

### 2.3 Empirical Review

Empirical studies have produced mixed findings on the role of guarantees in credit performance. Abubakar et al. (2020) opine that effective credit risk management significantly improves financial performance in Nigerian MFBs, though they did not isolate the effect of guarantor cheques. Afolabi (2021) also establishes that credit management practices strongly influence loan performance, but overlook guarantee mechanisms.

Internationally, Cowling (2010) and Uesugi et al. (2010) reported that government-backed guarantees improved SME access to credit and reduced default rates. In contrast, Liu et al. (2016) and Khan et al. (2024) emphasised that guarantees may also increase the guarantor's financial burden, especially when enforcement is weak. These divergent findings highlight the need to examine the local institutional context, particularly in developing economies where formal enforcement mechanisms are weak.

This study contributes by focusing specifically on guarantor cheques — a prevalent but underexplored instrument in Nigerian microfinance lending.

## METHODOLOGY

### 3.1 Research Design

The study adopts a survey research design, suitable for collecting primary data from Managing Directors (MDs) of MFBs in Lagos. These respondents were chosen because of their direct involvement in credit approval and risk management decisions.

### 3.2 Population and Sample Size

The population consists of all 179 licensed MFBs in Lagos State (CBN, 2025). Using Taro Yamane's formula, the ideal sample size would be 124. However, due to time and resource constraints, 18 Managing Directors were purposively selected based on their experience and decision-making roles. While this small sample size limits external validity, it provides in-depth institutional perspectives, aligning with the study's exploratory design.

### 3.3 Data Collection and Analysis

Data were obtained through structured questionnaires using a 5-point Likert scale to measure perceptions of guarantor cheque effectiveness, loan performance, and control variables. The responses were analysed using multiple regression analysis in Stata. Reliability and validity were ensured through pilot testing and diagnostic checks for multicollinearity and heteroskedasticity.

### 3.4 Model Specification

$LP_i = \beta_0 + \beta_1 GC_i + \beta_2 CV_i + \beta_3 Dev_i \, \epsilon_i$ …………………………main model

Where:

1. LP = Loan Performance (Dependent variable - default rate)
2. GC = Guarantor's Cheque (Independent variables - cheque value, bouncing frequency) • CV = Control Variables (interest rate, loan size)

ISSN No. 2454-6194 | DOI: 10.51584/IJRIAS |Volume X Issue X October 2025

3. Dev = Demographic Variables (Age, gender, experience, education)
4. ε = Error term

## RESULTS

**Table 1: Regression Analysis**

| Source | SS | df | MS |
|---|---|---|---|
| Model | 3.92861419 | 6 | 6.654769031 |
| Residual | 12.52354676 | 11 | 11.22941334 |
| Total | 16.45216094 | 17 | 17.37953888 |

Number of obs = 18

F(6, 11) = 2.85

Prob > F = 0.0628

R-squared = 0.6089

Adj R-squared = 0.3955

Root MSE = 4.78797

**Regression Coefficients Table**

| Variable | Coef. | Std. Err. | t | P>\|t\| | 95% Conf. Interval |
|---|---|---|---|---|---|
| $IV_1$_Score | 0.7882389 | 0.197318 | 3.99 | 0.002 | 0.3539449 – 1.222533 |
| $CV_2$_Score | -1.834909 | 3.423096 | -0.54 | 0.603 | -9.360993 – 5.5699275 |
| age | -0.0527841 | 0.3062432 | -0.17 | 0.866 | -0.7268029 – 0.6215227 |
| gender | -0.2851126 | 0.3059333 | -0.93 | 0.371 | -0.9584763 – 0.3882421 |
| education | -1.429304 | 1.902025 | -0.75 | 0.468 | -5.61603 – 2.757422 |
| experience | 0.0162707 | 0.2629263 | 0.06 | 0.952 | -0.564261 – 0.5949676 |
| _cons | 1.847712 | 2.469257 | 0.75 | 0.470 | -3.587085 – 7.28251 |

The regression results show that guarantor cheques, control variables, and demographic factors explain about 61% of the variation in loan performance ($R^2 = 0.6089$). However, the overall model is not statistically significant at the 5% level ($p = 0.0628$).

While guarantor cheques alone show some correlation with loan performance ($\beta = 0.788$, $p < 0.05$), other variables such as loan size, interest rate, and demographics were not significant predictors. These findings imply that the impact of guarantor cheques is limited when considered alongside broader institutional and borrower factors.

## DISCUSSION

The results contrast with global evidence (e.g., Cowling, 2010; Khan et al., 2024), which finds that guarantees significantly enhance loan repayment. The discrepancy likely stems from Nigeria's weak legal enforcement and institutional inefficiencies.

From the Signaling Theory perspective, the ineffectiveness of guarantor cheques implies that the "signal" of repayment assurance is not credible. In environments with limited legal accountability, postdated cheques lose their deterrent power, making them a weak proxy for creditworthiness.

Furthermore, the findings suggest that institutional lending practices—such as risk assessment, borrower monitoring, and recovery strategies—play a greater role in loan performance than individual borrower characteristics. This highlights the need for microfinance institutions to shift from paper-based guarantees to technology-driven mechanisms like the Global Standing Instruction (GSI), which automatically debits defaulting borrowers' accounts across banks.

## CONCLUSION AND RECOMMENDATIONS

This study concludes that guarantor cheques have limited effectiveness in improving loan performance among MFBs in Nigeria. Their weak impact is largely attributed to poor enforcement of dud cheque laws and the inefficiency of manual recovery systems.

### Contributions

The study contributes to credit risk literature by providing empirical evidence from a developing economy context where traditional instruments like guarantor cheques remain prevalent but ineffective.

### Policy Implications

1. The Central Bank of Nigeria should accelerate the integration of GSI into microfinance operations to enhance recovery and reduce loan defaults.
2. MFBs should strengthen credit assessment frameworks, focusing on guarantor financial capacity rather than paper instruments.
3. Stakeholders should invest in borrower and guarantor education on the legal and financial implications of defaulting on guaranteed loans.

### Future Research

Subsequent studies should expand the sample size to include loan officers and multiple states, and explore digital credit risk management tools as alternatives to guarantor cheques.

## REFERENCES

1. Abdulhamid, J., Ibrahim, A., Abubakar, A. A., & Salisu, I. M. (2023). Effect of credit risk control on loan performance of microfinance banks. Creative Business Research Journal, 3(2), 77–83.
2. Abubakar, A. A., Tobi, B. O., & Abdullahi, H. A. (2020). Effect of credit risk management on the financial performance of listed microfinance banks in Nigeria. Research Journal of Finance and Accounting, 11(18), 1–9.
3. Afolabi, S. T. (2021). Impact of credit management strategies on loan performance among microfinance banks in Nigeria. Academy of Accounting and Financial Studies Journal, 25(4), 1–10.
4. Akhter, N. (2023). Determinants of commercial banks' non-performing loans in Bangladesh. Cogent Economics & Finance, 11(1), 1–15.
5. CBN. (2025). List of licensed microfinance banks in Nigeria. Retrieved from https://www.cbn.gov.ng
6. Connelly, B. L., Certo, S. T., Ireland, R. D., & Reutzel, C. R. (2011). Signaling theory: A review and assessment. Journal of Management, 37(1), 39–67.
7. Cowling, M. (2010). The role of loan guarantee schemes in alleviating credit rationing in the UK. Journal of Financial Stability, 6(1), 36–44.
8. Khan, M. B., Kayani, U. N., Saleem, H., & Aysan, A. (2024). Loan guarantee, management earnings forecasts and cost of debt: Evidence from Chinese manufacturing firms. Cogent Economics & Finance, 12(1), 1–22.
9. Liu, B., Cullinan, C., Zhang, J., & Wang, F. (2016). Loan guarantees and the cost of debt: Evidence from China. Applied Economics, 48(38), 3626–3643.
10. Nkusu, M. (2011). Nonperforming loans and macro-financial vulnerabilities in advanced economies. IMF Working Paper, 11(161), 3–27.

11. Nwikpasi, N. T. (2015). Guarantee contracts in Nigeria. Journal of Law and Global Policy, 1(8), 34–42.
12. Orok, A. B., Okon, E. A., & Titus, I. T. (2023). Optimising bank performance through loan recovery in Nigeria. Journal of Business Strategy, Finance and Management, 5(1), 88–102.
13. Uesugi, I., Sakai, K., & Yamashiro, G. M. (2010). The effectiveness of public credit guarantees in the Japanese loan market. Journal of the Japanese and International Economies, 24(1), 457–480.
14. Umar, N. (2022). Examining the determinants of loan default among microfinance banks' borrowers in Kano State, Nigeria. International Journal of Financial, Accounting, and Management, 3(4), 335–347.