THE CAUSES AND IMPACTS OF LOAN DEFAULT TO MICROFINANCE INSTITUTIONS (MFIs) ACTIVITIES

THE CASE OF PRIDE TANZANIA LTD PAMBA BRANCH- MWANZA
THE CAUSES AND IMPACTS OF LOAN DEFAULT TO MICROFINANCE INSTITUTIONS (MFIs) ACTIVITIES: A CASE OF PRIDE TANZANIA LTD PAMBA BRANCH- MWANZA

By

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A Research Dissertation Submitted in Fulfillment of the Requirements for Award of the Masters of Business Administration in Corporate Management (MBA-CM) of Mzumbe University

2015
CERTIFICATION

We, the undersigned, certify that we have read and hereby recommend for acceptance by the Mzumbe University, a dissertation/thesis entitled, The causes and impacts of loan default to microfinance institutions (MFIs) activities: A case of Pride Tanzania Ltd Pamba Branch- Mwanza in partial/ fulfilment of the requirements for award of the degree of Master of Business Administration (Corporate Management) of Mzumbe University.

Signature

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Internal Examiner

Accepted for the Board of ……………………

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I, MOSSES ELIUD MUNGURE, declare that this research report is my own original work and that it has not been presented and will not be presented to any other university for a similar or any other degree award.

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ABBREVIATIONS AND ACRONYMS

MFIs                  Microfinance Institutions
MSEs                  Micro and Small Enterprises
URT                   United Republic of Tanzania
PRIDE                 Promotion of Rural Initiative and Development Enterprise
MFT                   Microfinance Transparency
NGOs                  Non-Governmental Organizations
SACCOS                Savings and Credit Cooperative Society
SIDO                  Small Industries Development Organization
FINCA                 Foundation for international Community Assistance
NMB                   National Microfinance Bank
PRIDE                 Promotion of Rural Initiative and Development Enterprises
PTF                   Presidential Trust Fund
SEDA                  Small Enterprise Development Agency
ACB                   Akiba Commercial Bank
SELFINA               SERO Lease and Finance Limited
YOSEFO                Youth Self Employment Foundation
CRDB                  Cooperative Rural Development Bank
ABSTRACT

This study was conducted in order to find out the impacts and causes of loan default to MFIs activities using PRIDE Tanzania ltd- Pamba branch in Mwanza as a case study. This study specifically focused on finding out the impacts of loan default on MFIs operational costs, income, profit and lending, examining extent in which loan supervision, monitoring and control affects loan repayment, identifying whether multiple borrowing by clients leads to loan default, finding out whether the use of funds by clients for unintended purpose contribute to loan default.

Research design used was case study design. The study carried out in Mwanza region in Nyamagana and Ilemela district sample size comprised of 100 clients who benefit from PRIDE Tanzania ltd services and 10 loan officers of PRIDE Tanzania ltd. Sampling techniques adopted was Simple random sampling technique used for loan officers and Purposive sampling technique used in sampling MFIs clients. Data was processed through Statistical Package for Social Scientist and analyzed and presented in the form of frequencies, percentages and tables.

The study findings revealed that interest rates charged on loans, diverting funds from its intended use, multiple borrowing has a direct impact on repayment. The research also revealed some of the causes that contributed to the default by some customers such as lack of collateral and high interest rates. The study also concluded that formation of strong solidarity groups is key to preventing high arrears. MFIs should also provide appropriate training and supervision to clients regarding the use of their loans. Further more MFIs should have clear and effective credit or lending policies and procedures and must be regularly reviewed.
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CHAPTER ONE
INTRODUCTION

1.1 Background of the Problem
Microfinance Institutions (MFIs) were established for the purpose of providing one or a combination of micro loans, savings, business advice and training to Micro and Small Enterprises (MSEs). MFIs and particularly those with poverty related missions were established to help the poor access loans by financing MSEs (Fraizer and Kazi, 2004).
Extension of credit facilities is one of the major activities of all Microfinance institutions including Savings and Loans Companies, Rural banks, Financial Non-Governmental Organizations (FNGOs) and credit Unions. This is usually evidenced by the large proportion that loans constitute in the overall operating assets of these lending institutions.

The Tanzanian government through national microfinance policy of 2000 sets the best practices for delinquency control so as to get loans repaid which includes maintenance and active use of accurate, up to date information on portfolio status(at various level of the organization) including aging of arrears, implementation of appropriate provisioning and write-off policies and delinquency management(URT,2000).

Healthy loan portfolios are therefore vital for lending institutions in view of their impact on Liquidity, lending capacity, earnings and profitability of the Microfinance Institutions. Nonetheless some of the loans given out by the lending institutions unfortunately are not paid back and eventually result in bad debts with adverse consequences for the overall financial performance of the institutions. The issue of loan defaults becoming an increasing problem that threatens the sustainability of microfinance institutions. The causes of the problem are multi-dimensional and non-uniform among different literatures. Unsettled loans are always a source of misery for lenders because if a microfinance has too much of it on its balance sheet, it can
adversely affect its operations in terms of liquidity, profitability, debt-servicing capacity, Lending capacity and ability to raise additional capital. High default rates in SMEs lending should be of major concern to policy makers in developing countries, because of its unintended negative impacts on SMEs financing (Ntiamoah et al, 2014).

Von-Pischke (1980) states that some of the impacts associated with default include: the inability to recycle funds to other borrowers; unwillingness of other financial intermediaries to serve the needs of small borrowers; and the creation of distrust. As noted by Baku and Smith (1998), the costs of loan delinquencies would be felt by both the lenders and the borrowers. The lender has costs in delinquency situations, including lost interest, opportunity cost of principal, legal fees and related costs. For the borrower, the decision to default is a trade-off between the penalties in lost reputation from default versus the opportunity cost of forgoing investments due to working out the current loan.

1.2 Statement of the Problem
Micro Finance Institutions (MFIs) are increasingly a central source of credit for the poor in many countries. Weekly collection of repayment installments by bank personnel is one of the key features of micro-finance that is believed to reduce default risk in the absence of collateral and make lending to the poor viable (Rosenberg, 1999).

According to Chossudovsky (1998), World Bank Sustainable Banking with the Poor project (SBP) in mid-1996 estimated that there were more than 1,000 microfinance institutions in over 100 countries, each having a minimum of 1,000 members and with 3 years of experience. In a survey of 2006 of such institutions, 73 per cent were NGOs, 13.6 per cent credit unions, 7.8 per cent banks and the rest savings unions.

Despite the growth of microfinance industry, MFIs are faced with default problems which pose a serious challenge to MFIs sustainability. There are various researches done to assess causes and impacts of loan default to MFIs activities. Researches done by Kofi
and Dadzie (2012) found that some of the reasons for default include poor sales, sickness, lack of planning ahead by clients, spending on unnecessary things by clients, poor record keeping and inadequate monitoring by loan officers. Moreover it was observed that implication of loan default to MFIs include inability to disburse more loan in future, reducing operating profits, loan able funds and undermining the liquidity. Therefore it is important to investigate the causes and impact of loan default to MFIs activities using PRIDE Tanzania limited Pamba branch in Mwanza as a case study. The focus is to identify causes and effects of default that has impeded MFIs sustainability so as to come up with the means to reduce/eliminate default in MFIs.

1.3 Research Objectives

1.3.1 General objective
This study is aimed at finding out the impacts and causes of loan default to MFIs activities.

1.3.2 Specific objectives
This study is conducted specifically to;

i. To find out impacts of loan default on MFIs operational costs, income, profit and lending.

ii. To examine extent in which loan supervision, monitoring and control affects loan repayment

iii. To identify whether multiple borrowing by clients leads to loan default

iv. To find out whether the use of funds by clients for unintended purpose contribute to loan default

1.4 Research Questions

i. What are the impacts of loan default on MFIs operational costs, income, profit and lending?

ii. To what extent loan supervision, monitoring and control affects loan repayment?
iii. How multiple borrowing by clients leads to loan default in MFIs?
iv. How the uses of funds by clients for unintended purpose contribute to loan default?

1.5 Significance of the Study

Provision of loans to SMEs which have no access to affordable financial services due to inability to meet conditional in those institutions like commercial banks is the core objective for MFIs existence. Loan default by clients pose a huge barrier to MFIs operations as there will be lack of funds to provide loans to other borrowers, limits growth and profitability. This study is conducted to assess reasons and impacts of loan default to MFIs sustainability so as to come up with the means of minimizing/eliminating the level of loan default by the clients that will be useful to MFIs, policy makers and other stakeholders.

1.6 Scope of the Study

This study focuses on causes and impact of loan default to MFIs activities in Tanzania using case study of PRIDE Tanzania ltd- Pamba branch in Mwanza. PRIDE Tanzania limited was selected for the purpose of this study because it has existed for many years and has a network of over 26 branches national wide and over 63000 clients with good and experienced administration system, therefore analysis of PRIDE Tanzania limited and its client’s activities will better provide necessary information that will provide a clear picture
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2.1 Definitions of Terms

2.1.1 Meaning of Microfinance
Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfer, and insurance to poor and low-income households and their micro enterprises. Microfinance does not only cover financial services but also non-financial assistance such as training and business advice (Kessy and Urio, 2006).

The principal providers of financial services to the poor and low income households in the rural and urban areas of Tanzania consist of licensed commercial banks, regional and rural unit banks; savings and credit cooperative societies; and several NGOs whose micro-credit delivery operations are funded and supported with technical assistance by international donors (Randhawa and Gallardo, 2003).

2.1.2 Microfinance and Microfinance Institutions (MFIs)
Microfinance has been defined as the provision of financial services such as deposits, loans, payment services, money transfers, and insurance to low-income, poor and excluded people enabling them to raise their income and living standards (Rhyne and Oreto, 2006). It consists of lending and recycling very small amounts of money for short periods. It is helping millions of poor people, especially poor rural women, with small loans so they can start or expand small business, create self-employment and improve their lives. Through microfinance coming in to being, the poor people not only obtained financial service in better way than from formal financial service, but also have been saved from exploitation by local creditors who charge extraordinary interest. In-line with this idea, Qayyum et al (2006) argued that, microfinance emerged as a noble substitute
for informal credit and an effective and powerful instrument for poverty reduction among people who are economically active but financially constrained and vulnerable in various countries.

Furthermore, Robinson (2001) forwarded an interesting comprehensive definition of microfinance as:

"Microfinance referred to small-scale financial services—primarily credit and saving—provided to people who farm or fish or herd; who operate small enterprises or microenterprises where goods are produced, recycled, repaired, or sold; who provide service; who work for wages or commissions; who gain income from renting out small amount of land, vehicles, draft animals, or machinery and tools; and to other individuals and groups at the local levels of developing countries, both rural and urban."

In other words, microfinance has been associated with helping or empowering the poor to account properly and independently for their small businesses and thus manage their livelihoods in better way. Other interesting trend is that, poverty alleviation has been a long-term goal of governments and key international institutions such as the World Bank, United Nations, and several organizations doing on development seeking the more effective way of reaching the poor.

The aspect of microfinance that attracted the attention of those development organizations as a strategy for poverty alleviation lies in its ability to reach the grassroots with financial services. As an innovative form of financial intermediation with the poor, microfinance is in effect double tasked to achieve specified developmental ends and goals through particular means such as group-lending methodologies through which the poor can borrow money and mutually assure their own progressive empowerment towards independent survival and self-management. (ADB, 2010)
Microfinance institutions are institutions that provide suitable financial and other services using innovative methodologies and systems at low cost to meet the need of low-income sections of the population and act as financial intermediaries in a genuine sense. (Wolday, 2000)

Microcredit, or microfinance, is banking the unbankables, bringing credit, savings and other essential financial services to reach millions of people who are too poor to be served by regular banks, in most cases because they are unable to offer sufficient collateral. In general, banks are for people with money, not for people without. (Maanen, 2004)

According to Yunus (2003), the innovator for modern Microfinance in Bangladesh, (Microcredit) is based on the premise that the poor have skills which remain unutilized or underutilized. It is definitely not the lack of skills that make poor people poor….charity is not the answer to poverty. It only helps poverty to continue. It creates dependency and takes away the individual’s initiative to break through the wall of poverty. Unleashing of energy and creativity in each human being is the answer to poverty.”

Financial institutions, donors (government and NGOs) and private equity are the three major fund sources of MFIs. Microfinance has widely been directed by the non-profit sector while commercial lenders require more conventional forms of collateral before making loans to microfinance institutions. Now it is successfully growing bigger and getting more credibility in the traditional finance world. Due to that, the traditional banking industry has begun to realize that these borrowers fit more correctly in a category called pre-bankable. The industry has realized that those who lack access to traditional formal financial institutions actually require and desire a variety of financial products. Nowadays the mainstream finance industry is counting the microcredit projects as a source of growth. (Robinson, 2001)
There are two major leading views about MFIs: the financial systems approach and the poverty lending approach. The financial systems approach emphasizes large-scale outreach to the economically active poor both to borrowers who can repay microloans from household and enterprise income streams, and to savers. The financial systems approach focuses on institutional self-sufficiency because, given the scale of the demand for microfinance worldwide, this is only possible means to meet widespread client demand for convenient, appropriate financial services. Whereas the poverty lending approach concentrates on reducing poverty through credit, often provided together with complementary service such as skills trainings and teaching of illiteracy, health, nutrition, family planning, and the like. Under this approach donor and government funded credit is provided to the poor borrowers, typically at below-market interest rates. Even though government and NGOs fund most MFIs, they are forced to cover the operating costs for the service they provide. This creates the interest rate by MFIs higher than the interest rate charged by formal financial institutions.¹

Microfinance includes a group of financial service innovations under the term of microfinance, other services according to microfinance is micro savings, money transfer vehicles, and micro insurance. Microcredit can be classified into four product types: income-generating loan, the midterm loan, the emergency loan and the Individual Loan. Microcredit is an innovation for the developing countries; it is a service for poor people that are unemployed, entrepreneurs, or farmers who are not bankable. The reason why they are not bankable is the lack of collateral, steady employment, income and a verifiable credit history, because of this reasons they cannot even meet the minimal qualifications for an ordinary credit. By providing people with microcredits it gives them more available choices and opportunities with a reduced risk. It has successfully enabled

¹ ibid
poor people to start their own business generating or sustain an income and often begin to build up wealth and exit poverty.  

2.1.3 Product of Microfinance

MFI is a kind of financial institution, which performs at least some of what other financial institutions are doing. MFIs provide diversified financial product through which they address the needs of their clients. According to CGAP (2002), financial product of MFIs, even though not limited to, can be categorized as:

2.1.3.1 Microcredit.

It is a small amount of money lend to a client by MFIs. Microcredit can be offered, often without collateral, to an individual or through group lending. The idea that a loan of a modest size (microcredit) can help the poorest to escape their condition is credited to Muhammad Yunus and the experience of the Grameen Bank in which millions of poor have benefited from small loans to support their business

2.1.3.2 Micro savings:

Micro savings are deposit services that allow one to save small amounts of money for future use. These savings allow households to save in order to meet unexpected expenses and plan for future expenses. For MFIs the collection of the saving represents a fundamental instrument in achieving sustainability. Indeed, for the poor and more generally, for financially excluded people, access to deposit service allows them to manage emergencies and to meet expected expense such as education, marriage ceremonies, old age, and death.

[^2]: ibid

[^3]: www.mixmarket.org, visited on July 5, 2015
2.1.3.3 Micro insurance:

It is a system by which people, businesses and other organizations make a payment to share risk. Access to insurance enables entrepreneurs to concentrate more on developing their businesses while mitigating other risks affecting property, health or the ability to work. (Morduch, 2005)

2.1.3.4 Payment services:

Alongside the other financial products, certain MFIs have begun to offer payment services. These are included in the category of financial service that the poor request in order to have the possibility of transferring money through secure channel. However, due to the complexity of the infrastructures and the facilities that the payment system requires, MFIs that provide such service are not numerous in number.

2.1.3.5 Intermediation:

Involves mobilizing and transferring savings from surplus to deficit units and provides safe, liquid, and convenient savings (deposit) facilities and access to credit facilities tailored to the needs of the rural population.

2.1.3.6 Micro leasing:

For entrepreneurs or small businesses who cannot afford to buy at full cost, they can instead lease equipment, agricultural machinery, or vehicles.⁴

2.1.4 Major types of microfinance institutions

Institutional innovation in microfinance does not necessarily mean to create a new institutional type at the international level, but includes the adaptation of an existing institutional type to the constraints and potentials of a certain client group in a specific

⁴www.microfinanceinfo.com visited on July 5, 2015
local environment. In the following section, the five major types of MFIs are presented. (Melak, 2010)

2.1.4.1 Multi-purpose Co-operatives model (MPCM):

The model of microfinance provision that is most suitable for the poverty lending approach is the MPCMs. They are legally established, co-operative financial institutions that are chartered and supervised under national co-operative legislation. MPCMs were initially set up to ensure market coordination, information provision and setting standards for agricultural purposes.

Co-operatives are voluntary associations of people at the grassroots level. They are formed as autonomous, self-help groups aimed at assisting members who are unable to get financial services from the commercial banking sector, due to the lack of conventional collateral. In Namibia MPCMs offer microfinance as part of a wider set of services (Oreto, 1994).

Groups of co-operatives form a league. They are governed by one of four regional confederations. These regional confederations fall under an apex body called the World Council of Credit Unions (WOCCU).

They are organized and operated according to the basic co-operative principles outlined below:

- Members are the owners of the institutions;
- Each member has the right to one vote;
- There are no external shareholders;
- Policy-making leadership is drawn from the members themselves, and in new or small cooperatives these positions are unpaid.
Co-operatives have been operating in developing countries since 1950. They provide a basic set of services that cater to the pre-entrepreneurial target group, who typically can only access them from the informal sector.

The valuable role MPCMs play in the provision of ancillary services is argued to be more important to their target group than credit. The provision of these additional services cannot be scaled up unless a new institution is created to provide these ancillary services and donor or government funded; pre-paid vouchers are disbursed by the co-operative to their members to access these services.

This report recognizes that in practice there is a large amount of overlap between the cooperative and village banking model. They differ in that the latter depends on donor financing for seedcapital and does not necessarily have to rely on group lending.

2.1.4.2. Solidarity groups:

Manfred (2001) indicated that the second types of MFIs are solidarity credit groups;

- Participation: Three to ten clients join a group to receive access to financial services (primarily credit). They may have to save before receiving a loan.
- Complementary services: In addition to financial services, the support agency may offer non-financial services, such as training or market information, to the group members.
- Responsibilities: Group members collectively guarantee loan repayment, and access to subsequent loans is given only if previous loans are paid in full.
- Profit sharing: The profits are not shared among the members, but used to build up group funds and emergency reserves. The ownership of these funds is often unclear. Intra group savings accounts may be opened; they can be used according to the members' wishes.
- Structure: The group (three to ten members on average) can join a center (around five groups). The center allows for economy of scale in disbursement of loans,
collection of savings or repayment, and training. The upper level (regional or national) is in charge of decision-making (top-down approach).

2.1.4.3 Village banks.

The model of microfinance provision that is most suitable for the financial systems approach is the village bank. These institutions are involved solely in the provision of microfinance and do not provide non-financial services. They include community managed savings and credit associations (SCA’s) or savings and credit cooperative (SACCO).

SCAs or SACCOs typically consist of a general membership of 30 to 50 members based on self-selection, and an elected committee that is responsible for convening meetings, approving loans, uprising loan payments, receiving savings deposits, lending out or investing savings and keeping up-to-date records.

The design of this model is based on the Village Bank Manual by John and Marguerite. It consists of a sponsoring agency envisioned to require very little administrative overhead that supports several SCAs or SACCOs through promoters who train and organize them and then lend seed capital to these newly established institutions as for on lending to members who have gone through a trial period. Twenty percent of each disbursed loan is withheld as collateral and to build a fund that is used in the future financing of new loans or collective income generating. No interest is paid on share savings; instead, members receive a share of profits from the SCA’s or SACCO’s re-lending activities or other investments (dividends).

2.1.4.4. The Linkage model,

Manfred, (2001) indicated that the fourth model builds on existing informal self-help groups (SHGs), such as rotating credit and savings associations described in the article by Sika and Strasser in this issue. The linkage model seeks to combine the strengths of existing informal systems (client proximity, flexibility, social capital, reaching poorer
clients) with the strengths of the formal system (e.g. risk pooling, term transformation, provision of long-term investment loans, financial intermediation across regions and sectors). The main principles are:

- Participation: Members of a SHG enter into a group contract with a bank that provides savings and credit services to the group. An intermediary NGO may provide complementary services, such as training or certification of creditworthiness of groups.
- Responsibilities/profit sharing: The bank, sometimes assisted by an NGO, provides the services. Internally, the SHG may organize member-managed savings accounts.
- Structure: The SHG is linked to the bank through a group contract. Individual members of the SHG do not have any links with the bank.

2.1.4.5. Micro banks with individual financial contracts.

The above four MFIs are member-based. Members contribute to a varying degree in the management, ownership and control of the MFI. On the other hand, micro banks mainly rely on individual contracts between the institution and its client. This type of MFI is closest to the classical banks. However, the loan collateral may not be conventional, using for example savings of the client, knowledge on his/her creditworthiness, or other persons as guarantees of the loan. It is obvious that clients prefer to have an individual loan if they could get it on the same terms as those provided by member-based institutions, such as the first four types described. This is so because participation in any of the above MFI types carries additional transaction costs on behalf of the client (for example for meetings). Yet, in order to reduce transaction costs for the MFI itself, member-based institutions can be more efficient in environments with lower population density, higher illiteracy, and poor road and communications infrastructure. It is therefore not surprising that micro banks saw their greatest success so far in urban areas.
of better-off developing or transformation countries. Some of the main principles of micro banks are:

- Participation: Clients are selected by the micro bank based on creditworthiness.
- Responsibilities/profit-sharing: The client is individually responsible for loan repayment, and is not involved in management, ownership, or profit-sharing.
- Structure: Emphasis is given on a decentralized structure that gives decision flexibility and strong performance incentives to managers of the micro banks.

2.1.5 Major Risks to Microfinance Institutions

Many risks are common to all financial institutions. From banks to unregulated informal sectors, these include credit risk, liquidity risk, market or pricing risk, operational risk, compliance and legal risk, and strategic risk.

2.1.5.1 Financial Risks

The business of a financial institution is to manage financial risks, which include credit risks, liquidity risks, interest rate risks, foreign exchange risks and investment portfolio risks. Most informal institutions have put most of their resources into developing a methodology that reduces individual credit risks and maintaining quality portfolios. Microfinance institutions that use savings deposits as a source of loan funds must have sufficient cash to fund loans and withdrawals from savings. Those institutions including saving and credit that rely on depositors and other borrowed sources of funds are also vulnerable to changes in interest rates. Financial risk management requires a sophisticated treasury function, usually centralized at the head office, which manages liquidity risk, interest rate risk, and investment portfolio risk. (GTZ, 2000)
2.1.5.2 Credit risk

Credit risk, the most frequently addressed risk for informal sectors, is the risk to earnings or capital due to borrowers’ late and non-payment of loan obligations. Credit risk encompasses both the loss of income resulting from the sector inability to collect anticipated interest earnings as well as the loss of principle resulting from loan defaults. Credit risk includes both transaction risk and portfolio risk. (GTZ, 2000)

2.1.5.3 Transaction risk

Transaction risk refers to the risk within individual loans. Informal sectors mitigate transaction risk through borrower screening techniques, underwriting criteria, and quality procedures for loan disbursement, monitoring, and collection (Meron, 2007).

2.1.5.4 Portfolio risk

Portfolio risk refers to the risk inherent in the composition of the overall loan portfolio. Policies on diversification (avoiding concentration in a particular sector or area), maximum loan size, types of loans, and loan structures lessen portfolio risk. (GTZ, 2000)

2.1.5.5 Liquidity risk

Liquidity risk is the possibility of negative effects on the interests of owners, customers and other stakeholders of the financial institution resulting from the inability to meet current cash obligations in a timely and cost-efficient manner. Liquidity risk usually arises from management’s inability to adequately anticipate and plan for changes in funding sources and cash needs. Efficient liquidity management requires maintaining sufficient cash reserves on hand (to meet client withdrawals, disburse loans and fund unexpected cash shortages) while also investing as many funds as possible to maximize earnings (putting cash to work in loans or market investments). (GTZ, 2000.)
2.1.5.6 Market risk

Market risk includes interest rate risk, foreign currency risk, and investment portfolio risk. (GTZ, 2000)

- Interest rate risk

Interest rate risk arises from the possibility of a change in the value of assets and liabilities in response to changes in market interest rates. Also known as asset and liability management risk, interest rate risk is a critical treasury function, in which financial institutions match the maturity schedules and risk profiles of their funding sources (liabilities) to the terms of the loans they are funding (assets). (GTZ, 2000)

2.1.6 Credit Methodology

Credit methodology lies at the heart of formal and non-formal institutions and its quality is one of the most determinant factors for the efficiency, impact, and profitability of the institutions. Credit methodology is comprised of a host of activities involved in lending including sales, client selection and screening, the application and approval process, repayment monitoring, and delinquency and portfolio management. It is also linked to the institutional structure and human resource policies such as hiring, training, and compensating staff. Getting the credit methodology and product mix right is therefore one of the most demanding as well as rewarding challenges of every institutions. (GTZ, 2000)

2.6.1.1 Credit Approval Process

The individual steps in the credit approval process and their implementation have a considerable impact on the risks associated with credit approval. The quality of credit approval processes depends on two factors, i.e. a transparent and comprehensive presentation of the risks when granting the loan on the one hand, and an adequate assessment of these risks on the other.
Furthermore, the level of efficiency of the credit approval processes is an important rating element. Due to the considerable differences in the nature of various borrowers and the assets to be financed as well the large number of products and their complexity, there cannot be a uniform process to assess credit risks (Oesterreichische, 2000).

According Oesterreichische to The quality of the credit approval process from a risk perspective is determined by the best possible identification and evaluation of the credit risk resulting from a possible exposure. The credit risk can distributed among four risk components.

a. Probability of default (PD)
b. Loss given default (LGD)
c. Exposure at default (EAD)
d. Maturity (M)

The most important components in credit approval processes are PD, LGD, and EAD. While maturity (M) is required to calculate the required capital, it plays a minor role in exposure review. The significance of PD, LGD, and EAD is described below.

**a. Probability of default (PD)**

Reviewing a borrower’s probability of default is done by evaluating the borrower’s current and future ability to fulfill its interest and principal repayment obligations. This evaluation has to take into account various characteristics of the borrower (natural or legal person), which should lead to a differentiation of the credit approval processes in accordance with the borrowers served by the bank. Furthermore, it has to be taken into account that for certain finance transactions interest and principal repayments should be financed exclusively from the cash flow of the object to be financed without the possibility for recourse to further assets of the borrower. In this case, the credit review must address the viability of the underlying business model, which means that the source
of the cash flows required to meet interest and principal repayment obligations has to be included in the review. (Oesterreichische, 2000).

b. Loss given default (LGD)

The loss given default is affected by the collateralized portion as well as the cost of selling the collateral. Therefore, the calculated value and type of collateral also have to be taken into account in designing the credit approval processes. (Oesterreichische, 2000).

c. Exposure at default (EAD)

In the vast majority of the cases described here, the exposure at default corresponds to the amount owed to the institution. Thus, besides the type of claim; the amount of the claim is another important element in the credit approval process. (Oesterreichische, 2000).

2.1.6.2. Credit Decisions

Extending credit is a careful balance of limiting risk and maximizing profitability while maintaining a competitive edge in a complex, global marketplace. Credit analysis is the process of deciding whether to extend credit to a particular customer. It involves two steps: gathering relevant information and determining credit worthiness. (Stephen et al, 1999)

2.1.6.2.1 Credit Information

If a firm wants credit information on customers, there are a number of sources. Information sources commonly used to assess credit worthiness include the Financial statements: A firm can ask a customer to supply financial statements like balance sheet and income statement. Rules of thumb base on financial ratios can be calculated. (Ross et al, 1998)
2.1.7 Default
Default refers to a situation where a loaned fails to repay a loan. It occurs when a borrower cannot or will not repay the loan and the MFI no longer expects to receive payment (Maina and Kalui, 2014). Default can be of two types which are debt service default and technical default. Debt service default occurs when the borrower has not made a scheduled payment of interest or principal whiles technical default occurs when an affirmative or a negative covenant is violated. However, the latter is not very common in microfinance institutions but mainly applies to banks. Loan default has been identified as probably the single largest reason for the downfall of institutions involved in the provision of credit. Thus the goal of achieving minimum loan default to ensure healthy loan portfolio will ultimately lead to the sustainability of MFIs (Mensah, 2013).

2.1.8 Causes and Controls of Loan Default
Microfinance institutions must accept the fact that, most loan default cases are caused not only by bad borrowers. Aside the behavior on the part of borrowers which includes diversion of loans, over-borrowing, etc. which has been noticed to have contributed to loan default, the MFIs are also noticed to have contributed to the loan default. They have not played their part well in implementing an effective methodology as to how to grant micro credits. In view of this, there have been various control methods. The MFIs should constantly create an image and philosophy that does not consider late payments acceptable. The benefit of creating disciplined borrowers is critical to the success of the microfinance institution, in their quest to eradicate poverty. The Loan products should be carefully designed suit clients’ needs, and also ensure that, the delivery process is convenient (Mensah, 2013).

2.1.8.1 Delinquency
– In micro-finance this term refers to a situation where a loan is past “due”. It is an occurrence in a loan portfolio where payments are in arrears. A loan account is termed
as delinquent when payment is due and a loanee has failed to honor a payment obligation at the stipulated time (Maina and Kalui, 2014)

2.1.8.2 Past due
– This is loan installment that has not been paid at the period stipulated in the loan contract (Maina and Kalui, 2014)

2.1.8.3 Arrears
– Refers to a late payment, partial payment or a skipped payment (Maina and Kalui, 2014)

2.1.9 Microfinance industry in Tanzania
There are three main categories of microfinance institution (MFI) in Tanzania, the first being non-governmental organizations (NGOs). The most prominent NGOs include PRIDE TZ, FINCA, SEDA and PTF. Banking institutions also offer a range of microcredit products. The largest banks are the National Microfinance Bank (NMB), CRDB bank and Akiba Commercial Bank (ACB). There are a few regional and community banks, namely Dar es Salaam Community Bank, Mwanga Community Bank, Mufindi Community bank, Kilimanjaro Cooperative Bank, Mbinga Community Bank and Kagera Cooperative Bank. Lastly, cooperative based institutions (SACCOS), which are not regulated by the Bank of Tanzania, provide financial services that are predominately savings based. Examples include Small Industries Development Organization (SIDO), YOSEFO, SELFINA, Tanzania Gatsby Trust, Poverty Africa and the Zanzibar based Women Development Trust Fund (MFT, 2011)

The microfinance industry in Tanzania is relatively young and limited in scale. The World Bank estimates that less than 20% of Tanzania’s working population –
approximately 13 million people – has access to mainstream banking services \(^5\). In an attempt to address this, many banks have recently begun targeting the poor by extending collateral-free and low interest microcredit and loans. Due to lack of skills and experience within the market these efforts are not widespread and mostly favor borrowers in urban areas, leaving the rural areas largely underserved. Of the estimated 800 institutions providing financial services to low-income borrowers in Tanzania, most are reluctant to move into rural areas due to the poor national infrastructure, perceptions of high risk and due to the higher expense of operating costs (MFT, 2011).

Since 2003, there have been positive developments in Tanzania’s microfinance industry as numerous banks and financial institutions have provided increased funding either directly to beneficiaries or through intermediary institutions. Despite this progress, it is estimated that microfinance service providers have a combined outreach of approximately 500,000 clients, which is only about 5% of the estimated total demand. Another noteworthy group of Tanzanian microfinance service providers consists of non-institutional actors who generally operate in the informal sector. These include rotating savings and credit groups, rural savings and credit schemes, and moneylenders. Although there are numerous providers in this field, there are no reliable statistics on their lending patterns. These providers operate informally and offer valuable, but limited and often expensive microfinance services (MFT, 2011)

### 2.2 Theoretical Review

My study is based on A theory of Micro-Loan Borrowing Rates and Defaults and Grameen solidarity group theory.

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2.2.1 A Theory of Micro-Loan Borrowing Rates andDefaults
This theory was created by Cheung and Sundaresan (2007) in their article “Lending without Access to Collateral- A theory of Micro-Loan Borrowing Rates and Defaults”, where they presented a simple model of lending without collateral. The lender attempts to enforce the contract by relying on three things:

a) Monitoring to reduce the diversion of resources by the borrower from productive uses,

b) Peer monitoring by lending to a group, which is jointly-liable for the fulfillment of the contractual provisions, and

c) A punishment technology that imposes a finite cost on defaulting group of borrowers.

They showed that peer monitoring combined with a limited amount of monitoring by lenders is sufficient to reduce default probability to acceptable levels, so long as there is a credible punishment cost. Excessive monitoring by lenders increases the cost of borrowing and this might lead to non-participation by borrowers. As the loan size increases, we show that the probability of default increases and the loan rates dramatically increase, unless the maturity of the loans is increased.

2.2.2 The Grameen Solidarity Group Theory
This model is based on group peer pressure whereby loans are made to individuals in groups of four to seven (Armendariz et al, 2005). Group members collectively guarantee loan repayment, and access to subsequent loans is dependent on successful repayment by all group members. Payments are usually made weekly. According to Armendariz et al, (2005) solidarity groups have proved effective in deterring defaults as evidenced by loan repayment rates attained by organizations such as the Grameen Bank, who use this type of microfinance model. They also highlight the fact that this model has contributed to broader social benefits because of the mutual trust arrangement at the heart of the group guarantee system. The group itself often becomes the building block to a broader social network.
2.3 Empirical Literature Review

Several studies have been done on the impacts and causes of loan default in MFIs. In a study done by Maina and Kalui (2014) where they assessed institutional factors contributing to loan defaulting in MFIs in Kenya. The study used primary data. The study target population compromise 59 MFIs. A descriptive survey design was used to carry out a census of 59 microfinance institution in Kenya, this is because of the small size population. The data was collected through a structured questionnaire and administered to MFIs loan officers for response. A total of 48 questionnaires were administered of which 45 were adequately respondent to and considered for analysis, this formed 94% response rate. The findings indicated that all the three factors tested had a significant impact on the loan default rate which are credit policies, loan recovery procedures, and loan appraisal process that are viewed as critical drivers of loan delinquency occurrence.

Bichanga and Aseyo (2013) conducted a study on the causes of loan default within MFIs in Kenya. They used a target population comprised a total of 400 loan borrowers and 200 MFIs out of which a sample of 150 was picked using simple random sampling for each stratum. The data was collected by use of structured and semi-structured questionnaire. The data was analyzed from questionnaires using both quantitative and qualitative techniques and tabulated by use of frequency tables. The study found out that loan repayment default was as result of non-supervision of borrowers by the MFIs, and also as a result of inadequate training of borrowers on utilization of loan funds before they received loans. The findings also revealed that most borrowers did not spend the loan amount on intended and agreed projects.

Another study done by Mpogole, H et al (2012), where he assessed multiple borrowing and its effect on loan repayment among clients and sustainability of MFIs in Iringa municipality in Tanzania. A sample of 250 micro finance clients from 6 MFIs at Iringa municipality was included in the survey. The six MFIs were BRAC Tanzania, FINCA,
PRIDE Tanzania, IDYDC, MBF, and Presidential Trust Fund (PTF). Results showed that prevalence of multiple borrowing at Iringa in Tanzania was very high. Over 70% of the 250 microfinance clients had at least two loans from different MFIs at the same time. In addition, about 16% had also borrowed from individual lenders. Major reasons for multiple borrowing were insufficient loans from MFIs, loan recycling, and family obligations. Over 70% of the respondents had problems in loan repayment because of multiple pending loans. They also found that education level and number of dependants of the respondent significantly influenced the number of loan contracts.

2.4 Conceptual Framework
Conceptual framework provides direction for this study. Diagrammatical description of variables below indicates relationship existing between loan default and MFIs activities. Loan default is influenced by loan supervision, monitoring and control, multiple borrowing and the use of funds for unintended purpose and MFIs operational costs, income and lending are affected by the level of loan default which also affects MFIs activities.
CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Research Design
The researcher used case study design to describe in detail a units in context in order to provide a deeper insight and a better understanding of the problem prevailing. The case study design involved the use of data collection techniques like questionnaires and interview in collecting data regarding the impact and causes of loan default to MFIs activities using PRIDE Tanzania ltd Pamba branch in Mwanza as the case study. Therefore this approach has been adopted because it is not possible to conduct research for the whole country due to resources constraints.

3.2 Study Area
The study carried out in Mwanza region in Nyamagana and Ilemela districts. These areas were selected because there was large number of small businesses which benefits from MFIs like shops, butcheries, restaurants, market entrepreneurs selling cereals, groceries and so on therefore data collection were easy and accurate.

3.3 Study Population
For the purpose of assessing the impact and causes of loan default to MFIs activities study population included all PRIDE Tanzania ltd clients doing businesses, loan officers and managers in Nyamagana and Ilemela districts where sample size drawn so as to provide responses from both sides loan officers and clients which helped to prevent biased and one sided results.

3.4 Units of Analysis
Units of analysis used for the purpose of this study included PRIDE Tanzania ltd clients, loan officers and managers. This study include such units of analysis because MFIs main stakeholders include its clients, employees and management, therefore results from data analysed from these units have provided credible results.
3.5 Sample Size and Sampling Techniques

3.5.1 Sample size

For the purpose of this study sample size comprised of 100 clients who benefit from PRIDE Tanzania Ltd services and 10 loan officers of PRIDE Tanzania Ltd. Such sample size was used because it provides a valid representation of an entire population and simplify data collection by minimizing costs and time used.

3.5.2 Sampling technique

In this study both probability and non-probability sampling techniques were used. Under probability sampling which gives all individuals in the population equal chances of being selected, simple random sampling technique were used so as each member of the population had an equal chance of being selected for example loan officers were randomly selected this helped to save time and cost in data collection.

Non probability sampling techniques does not give all individuals equal chances of being selected, under this type of sampling purposive sampling were used where researcher's judgment and knowledge were used in selecting individuals for example clients were purposely selected to include in the sample this helped to get needed information basing on personal judgment of the respondent.

3.6 Methods of Data Collection

Primary data was collected. Primary data collected through providing questionnaires to both loan officers and clients of PRIDE Tanzania Ltd and interview conducted using questionnaires designed. Clients who cannot read and write and those who for any other reason are unable to fill questionnaires are interviewed. The main aim of using questionnaires is that it helps in preliminary analysis of data and presentation of tables, charts and graphs becomes easy.

3.7 Data Analysis Methods

Primary data from questionnaires and interviews processed and analysed through Statistical Package for Social Scientist (SPSS). Data analyzed and presented in the form
of frequencies, percentages and tables so as to provide meaningful information for presentation of findings and recommendations. SPSS makes data analysis quickly as the program knows the location of cases and variables. Also SPSS is made specifically for analyzing statistical data and provide a wide range of methods, graphs and charts.
CHAPTER FOUR
ANALYSIS AND PRESENTATION OF RESULTS AND FINDINGS

4.1 Introduction

This chapter is about analysis of data and presentation of findings. The analysis covers the findings from the research questions, questionnaires and interviews with respondents.

4.2 Demographic of Respondents

4.2.1 Age of Respondents

The study found that 23% of the respondents are below 30 years, while the majority that is 48% of MFI borrowers is aged between 30 to 40 years and 29% of them are aged above 40 years. This implies that those aged between 30-40 years comprise a huge proportion of clients of MFI. Consider Table 1 below

<table>
<thead>
<tr>
<th>Age</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Below 30 years</td>
<td>23</td>
<td>23.0</td>
</tr>
<tr>
<td>30-40 years</td>
<td>48</td>
<td>48.0</td>
</tr>
<tr>
<td>Above 40 years</td>
<td>29</td>
<td>29.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Field Survey. 2015.
4.2.2 Gender of respondents

The study found out that gender distribution of the respondents showed that male customers representing 47 percent of the entire population of 100 and the 53 percent representing female customers. Consider table 2 and figure 1 below;

Table 2: Gender of respondents

<table>
<thead>
<tr>
<th>Gender</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>47</td>
<td>47.0</td>
<td>47.0</td>
<td>47.0</td>
</tr>
<tr>
<td>Valid</td>
<td>Female</td>
<td>53</td>
<td>53.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 1: Gender of respondents

Source: Field Survey. 2015.
4.2.3 Marital Status of Respondents

The study found out that 32 percent of the respondents were single, 53 percent were married, 9% of respondents divorced and finally 6% representing widows/widowers. Consider table 3 and figure 2 below;

Table 3: Marital Status of Respondents

<table>
<thead>
<tr>
<th>Marital status of respondents</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>single</td>
<td>32</td>
<td>32.0</td>
<td>32.0</td>
<td>32.0</td>
</tr>
<tr>
<td>married</td>
<td>53</td>
<td>53.0</td>
<td>53.0</td>
<td>85.0</td>
</tr>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>divorced</td>
<td>9</td>
<td>9.0</td>
<td>9.0</td>
<td>94.0</td>
</tr>
<tr>
<td>widow/widower</td>
<td>6</td>
<td>6.0</td>
<td>6.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Figure 2: A graph showing the marital Status of Respondents

Source: Field Survey 2015.
4.2.4 Number of Dependents of Respondents

From the study, 25 percent of the respondents had no people depending on them, between 1-3 dependants was represented by 40 percentage of the respondents, 3-10 dependants represented by 32 percent and 10 and above had 3 percent representing them. Consider table 4 and figure 3 below;

Table 4: Number of dependants

<table>
<thead>
<tr>
<th>Number of dependants</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>25</td>
<td>25.0</td>
<td>25.0</td>
<td>25.0</td>
</tr>
<tr>
<td>1-3</td>
<td>40</td>
<td>40.0</td>
<td>40.0</td>
<td>65.0</td>
</tr>
<tr>
<td>3-10</td>
<td>32</td>
<td>32.0</td>
<td>32.0</td>
<td>97.0</td>
</tr>
<tr>
<td>10 and above</td>
<td>3</td>
<td>3.0</td>
<td>3.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Figure 3: Number of dependants

Source: Field Survey 2015.
4.3 Descriptive analysis

Below responses are to show out some of the reasons why most of the customers default after taking loans from the microfinance institutions.

4.3.1 Rate of loan repayment.

The figure above shows that 38% of the customers were defaulting that is 30% disagree of paying their microcredit and 8% strong disagree of repaying. Also it showed that 62% of respondents usually repay their loans as 22% strongly agree and 40% moderate agree.

Consider table 5 and figure 4 below;

Table 5: Rate of loan repayment by clients

<table>
<thead>
<tr>
<th>Loan repayment</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>strongly agree</td>
<td>22</td>
<td>22.0</td>
<td>22.0</td>
<td>22.0</td>
</tr>
<tr>
<td>moderately agree</td>
<td>40</td>
<td>40.0</td>
<td>40.0</td>
<td>62.0</td>
</tr>
<tr>
<td>disagree</td>
<td>30</td>
<td>30.0</td>
<td>30.0</td>
<td>92.0</td>
</tr>
<tr>
<td>strongly disagree</td>
<td>8</td>
<td>8.0</td>
<td>8.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Figure 4: Rate of loan repayment by clients

Source: Field Survey 2015.
4.3.2 Whether loan is timely repaid by clients

The study found out that 32 percent of clients strongly agreed that they were able to timely repay loans at required maturity and 37 percent moderately agreed. Also 27 percent disagreed and 4 percent strongly disagreeing to be able to pay loans at maturity. Consider table 6 and figure 5 below;

Table 6: Whether loan is timely repaid by clients

<table>
<thead>
<tr>
<th>Loan repayment on time</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>strongly agree</td>
<td>32</td>
<td>32.0</td>
<td>32.0</td>
<td>32.0</td>
</tr>
<tr>
<td>moderately agree</td>
<td>37</td>
<td>37.0</td>
<td>37.0</td>
<td>69.0</td>
</tr>
<tr>
<td>disagree</td>
<td>27</td>
<td>27.0</td>
<td>27.0</td>
<td>96.0</td>
</tr>
<tr>
<td>strongly disagree</td>
<td>4</td>
<td>4.0</td>
<td>4.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Figure 5: Whether loan is timely repaid by clients

Source: Field Survey 2015.
4.3.3 Default due to the failure of loan officers to collect loans at maturity

The study found out that 16% of respondents strongly agree and 37% moderately agree that default occurs when loan officers fail to make a follow up on repayment. Also, 34% disagree and 13% strongly disagree. Consider table 1 and figure 1 below;

Table 7: Default due to the failure of loan officers to collect loans at maturity.

<table>
<thead>
<tr>
<th>Response</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>strongly agree</td>
<td>16</td>
<td>16.0</td>
<td>16.0</td>
<td>16.0</td>
</tr>
<tr>
<td>moderately agree</td>
<td>37</td>
<td>37.0</td>
<td>37.0</td>
<td>53.0</td>
</tr>
<tr>
<td>disagree</td>
<td>34</td>
<td>34.0</td>
<td>34.0</td>
<td>87.0</td>
</tr>
<tr>
<td>strongly disagree</td>
<td>13</td>
<td>13.0</td>
<td>13.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 6: Default due to the failure of loan officers to collect loans at maturity

Source: Field Survey 2015
4.3.4: If default occurs because loans do not require any collateral

The study found out that 13% strongly agreed and 15% moderately agreed that default occurs because loans do not require collateral while 46% disagreed and 26% strongly disagreed to that notion. Consider table 8 and figure 7 below:

Table 8: If default occurs because loans do not require collateral

<table>
<thead>
<tr>
<th>If default occurs where loans do not require collateral</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>strongly agree</td>
<td>13</td>
<td>13.0</td>
<td>13.0</td>
<td>13.0</td>
</tr>
<tr>
<td>moderately agree</td>
<td>15</td>
<td>15.0</td>
<td>15.0</td>
<td>28.0</td>
</tr>
<tr>
<td>disagree</td>
<td>46</td>
<td>46.0</td>
<td>46.0</td>
<td>74.0</td>
</tr>
<tr>
<td>strongly disagree</td>
<td>26</td>
<td>26.0</td>
<td>26.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 7: If default occurs because loans do not require any collateral

Source: Field Survey 2015.
4.3.5: Whether default is caused by high interest rates

The study found out that 41% strongly agreed and 39% moderately agreed that default occurs because of high interest rate charged on loans 16% disagreed and 4% strongly disagreed that interest is the reason. Consider table 9 and figure 8 below;

Table 9: Whether default is caused by high interest rates

<table>
<thead>
<tr>
<th>Response</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>strongly agree</td>
<td>41</td>
<td>41.0</td>
<td>41.0</td>
<td>41.0</td>
</tr>
<tr>
<td>moderately agree</td>
<td>39</td>
<td>39.0</td>
<td>39.0</td>
<td>80.0</td>
</tr>
<tr>
<td>disagree</td>
<td>16</td>
<td>16.0</td>
<td>16.0</td>
<td>96.0</td>
</tr>
<tr>
<td>strongly disagree</td>
<td>4</td>
<td>4.0</td>
<td>4.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 8: Whether default is caused by high interest rates

Source: Field Survey 2015.
4.3.6 Whether there is unintended use of loans

The study found out that 12% strongly agreed and 22% moderately agreed that they use the loan for business for unintended purposes. 42% disagreed and 24% strongly disagreed of doing that. Consider table 10 and figure 9 below;

**Table 10: Whether there is unintended use of loans**

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>strongly agree</td>
<td>12</td>
<td>12.0</td>
<td>12.0</td>
<td>12.0</td>
</tr>
<tr>
<td>moderately agree</td>
<td>22</td>
<td>22.0</td>
<td>22.0</td>
<td>34.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

**Figure 9: Whether there is unintended use of loans**

Source: Field Survey 2015.
4.3.7 Supervision on Loan Utilization

The study found that 54% of borrowers had been supervised by MFIs staff on loan utilization while 46% had not been supervised over the same. Non supervision of borrowers on loan utilization by MFI could lead to a high rate of default. Consider table 11 and figure 10 below;

**Table 11: Supervision on Loan Utilization**

<table>
<thead>
<tr>
<th>Supervision</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>54</td>
<td>54.0</td>
<td>54.0</td>
<td>54.0</td>
</tr>
<tr>
<td>No</td>
<td>46</td>
<td>46.0</td>
<td>46.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

**Figure 10: Supervision on Loan Utilization**

Source: Field Survey 2015.
4.3.8 Supervision on Loan Repayment

The study found out that 71% of the respondents indicated that they had been supervised by MFIs staff on loan repayments, while 29% of the respondents indicated that they had not been supervised on loan repayments. Consider table 12 and figure 11 below;

Table 12: Supervision on Loan Repayment

<table>
<thead>
<tr>
<th>Supervision on Loan Repayment</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>71</td>
<td>71.0</td>
<td>71.0</td>
<td>71.0</td>
</tr>
<tr>
<td>No</td>
<td>29</td>
<td>29.0</td>
<td>29.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: Field Survey 2015.
4.3.9 Training before receiving loans

The study found out that 63% of respondents indicated that they had received training before receiving loans, while 37% reported that they had not received any training before receiving loans. Consider table 13 and figure 12 below:

Table 13: Training before receiving loans

<table>
<thead>
<tr>
<th>Training before receiving loans</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>63</td>
<td>63.0</td>
<td>63.0</td>
<td>63.0</td>
</tr>
<tr>
<td>No</td>
<td>37</td>
<td>37.0</td>
<td>37.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: Field Survey 2015.
4.3.10 Training has Helped Increase Income

The study revealed that 89% of the respondents said that training helped increase their income, while 11% said that training before receiving the loan did not help them increase their income. Consider table 14 and figure 13 below;

Table 14: If Training has Helped Increase Income

<table>
<thead>
<tr>
<th>Response</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>89</td>
<td>89.0</td>
<td>89.0</td>
<td>89.0</td>
</tr>
<tr>
<td>No</td>
<td>11</td>
<td>11.0</td>
<td>11.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Valid</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 13: If Training has Helped Increase Income

Source: Field Survey 2015.
4.3.11 Respondents having multiple loans

The study revealed that 62% of respondents have two or more loans from different financial institutions and 38% respondents do not have multiple loans. Consider table 15 and figure 14 below;

**Table 15: Respondents having multiple loans**

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>62</td>
<td>62.0</td>
<td>62.0</td>
<td>62.0</td>
</tr>
<tr>
<td>No</td>
<td>38</td>
<td>38.0</td>
<td>38.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

**Figure 14: Respondents having multiple loans**

Source: Field Survey 2015.
4.3.12 Impact of multiple borrowing on loan repayment

The study revealed that 63% of respondents having multiple loans faced problems in loan repayment and 37% does not have problem on repayment. Consider table 16 and figure 15 below;

Table 16: Impact of multiple borrowing on loan repayment

<table>
<thead>
<tr>
<th>Impact of multiple borrowing on loan repayment</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>63</td>
<td>63.0</td>
<td>63.0</td>
<td>63.0</td>
</tr>
<tr>
<td>Valid</td>
<td>No</td>
<td>37</td>
<td>37.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 15: Impact of multiple borrowing on loan repayment

Source: Field Survey 2015.
4.4 Response from Loan Officers and Managers

4.4.1 Loan default in your organization

Respondents were asked to answer the question if there is loan default in your organization and their response was 80% of the respondents agree while 20% of the respondents disagree that there is no loan default in their organization. As below figure describe

Figure 16: Loan default in your organization

Source: Field Survey 2015.
4.4.2 If yes, which of the following account for the causes of loan default?

The study revealed that 40% of respondents believe that poor sales is the reason for default, 20% said unintended use of loan, 10% said inadequate supervision and monitoring and 30% argued that multiple borrowing is the main cause of default. Consider figure below;

Figure 17: The causes of loan default.

Source: Field Survey 2015.
4.4.3 Impacts of default on organizations operations

Respondents that responds on impacts of default on organizations operations argued that 40% of the respondents said inability to disburse more loan in the future as impact, other 40% said that loss of interest income and reducing profits, 10% of the respondents also said that Increasing operation as described in the figure below.

Figure 18: Impacts of default on organizations operations

Source: Field Survey 2015.
4.4.4 Measures taken by an organization to ensure timely repayment of loans

Respondents were asked to answer the question if there is measure on loan repayment and their response was 100% of the respondents agree measure on loan repayment in their organization. As below figure describe

Figure 19: Measures taken to ensure timely repayment of loans

Source: Field Survey 2015.
4.4.5 Measure taken on loan repayment

Respondents that respond on measure taken loan repayment argued that 50% of the respondents said legal action, other 40% said that Outsourcing (External solicitor/Debt collectors), 10% of the respondents also said that write off debts as described in the figure below.

Figure 20: Measure taken on loan repayment

Source: Field Survey 2015.
4.4.6 Factors for poor monitoring and supervision of loans

Respondents that respond on factors for poor monitoring and supervision of loans argued that 50% of the respondents said Staffing problem, other 30% said that all above (staffing problem and poor road network), 20% of the respondents also said that poor road network as described in the figure below.

Figure 21: Factors for poor monitoring and supervision of loans

Source: Field Survey 2015.
CHAPTER FIVE

DISCUSSION OF FINDINGS

5.1 Introduction

This chapter focuses on discussing the results and findings that has been analysed and presented in the previous chapter so as to establish the causes and impacts of default.

5.2 Demographic of respondents

5.2.1 Age of Respondents

The findings showed that majority of borrowers that is 48% aged between 30-40 years compared to 23% which are below 30 years and 29% which are above 40 years. This indicates that individuals aged between 30-40 years are more likely to engage in small businesses compared to other age groups and therefore are in need of financial services.

5.2.2 Gender of respondents

It was found that 53% of clients are female and 47% are males this suggests that male clients are few compared to female clients, therefore MFIs should focus on encouraging men to borrow more and engage in business activities in order to provide for their families and serve their communities.

5.2.3 Marital status of respondents

The study indicates that marital status of respondents showing that 53% were married and the rest were unmarried this imply that married people are more likely to engage in small business by taking microloans compared to unmarried. Therefore MFIs should put much emphasis on encouraging unmarried people to borrow so as to increase their market size.
5.2.4 Number of dependants of respondents

The study also enquire on the number of dependants the clients have. Number of dependants affects ability of a client to pay loans as the more dependants one has the more the possibility to fail to repay as loans from MFIs can be directed to family obligation rather than intended use. From the study 25% of respondents had no dependants, 40% have 1-3 dependants, 32% have 3-10 and 3% have 10 and more dependants. Therefore 3% of clients are most likely to default and 25% are most likely to repay on time compared to others.

5.3 Descriptive analysis

5.3.1 Whether loan is timely repaid by clients.

The study indicated that 38% of respondents were defaulting and 62% were not defaulting. Also it was found out that 63% of respondents were able to pay microcredit at maturity and the rest of respondents are unable to pay. Therefore this means that there is default problem and appropriate steps need to be taken to address the problem.

5.3.2 Default due to the failure of loan officers to collect loans at maturity

It was found that 53% of respondents believe that default happen because loan officers fail to come and collect their microcredit on the maturity time and 47% does not agree. This shows that there is somehow a problem of follow up on repayment by loan officers thus it has to be addressed.

5.3.3 If default occurs because loans do not require any collateral

It was found that 28% of respondents agree to the fact that clients default because the loans do not require any collateral and 72% do not agree. Even if few respondents agree the problem cannot be ignored and should be properly addressed as collateral is important to ensure repayment.
5.3.4 Whether default is caused by high interest rates

It was found that 80% of respondents agreed the fact that default is the product of higher interest rates but 20% did not agree. This proves that higher interest leads to clients fail to repay the loans as profit fail to cover for his expenses and interest rates, therefore MFIs should set reasonable interest rates that clients can afford.

5.3.5 Whether there is unintended use of loans

The study found that a total of 34% agreed to the fact that they used a loan for unintended purposes like paying for funeral, hospital bills, family obligations and so on where 66% disagree. Therefore MFIs has an obligation to ensure that their clients use their loans for intended purposes only in order to guarantee timely and full repayment.

5.3.6 Supervision on loan Utilization and loan repayment

The study found that 54% of borrowers had been supervised by MFIs staff on loan utilization while 46% had not been supervised. Also 71% of the respondents indicated that they had been supervised by MFIs staff on loan repayments, while 29% of the respondents indicated that they had not been supervised on loan repayments. Therefore the result shows that MFIs supervises more loan repayment than loan utilization which does not fully guarantee repayment as clients need to be supervised on how they use their loans and after that they have to be pressured to repay, if they utilize their loans poorly they cannot repay.

5.3.7 Training before Receiving Loans and Whether Training Has Helped Increase Income

The study found out that 63% of respondents indicated that they had received training before receiving loans, while 37 % reported that they had not received any training before receiving loans. Also it was revealed that 89% of the respondents said that training helped increase their income, while 11% said that training before receiving the loan did not help them increase their income. Therefore it has been shown that training
on how to use and repay loans has improved repayment and MFIs should focus on providing training their clients.

5.3.8 Impact of multiple borrowing on loan repayment

The study showed that 62% of all respondents had two or more loans, while about 63% of respondents having multiple loans faced problems in loan repayment and 37% does not have problem on repayment. Therefore it is clearly shown that multiple borrowing affects negatively repayment and has to be discouraged and MFIs should address such a problem.

5.4 Response from Loan Officers and Managers

5.4.1 Loan default in MFI

The study found that 80% of the respondents agree while 20% of the respondents disagree that there is loan default in their organization. Also respondents that responds that there is loan default in their organization argued that 20% of the respondents said that the causes of loan default is when borrower use loans for unintended purpose, other 30% said that borrower has tendency of multiple borrowing, 10% of the respondents also said that Inadequate supervision and monitoring by loan officers and last with 40% of the respondents said that poor sales lead to the loan default. Therefore MFIs should collect all necessary information about their clients of their business records and trends, whether they have multiple loans and use that information to make correct lending decision. Also MFIs should emphasize monitoring and supervision of borrowers.

5.4.2 Impacts of default on organizations operations

It was found that 40% of the respondents said default leads to inability to disburse more loan in the future, other 40% said that loss of interest income and reducing profits, 10% of the respondents also said that Increasing operation costs. Therefore those responses indicate that default has negative impact on MFIs sustainability and growth.
5.4.3 Measure taken on loan repayment

All respondents agreed that there are measures taken by an organization towards default problem, 50% of the respondents said legal action is taken as a measure, other 40% said that Outsourcing (External solicitor/ Debt collectors), 10% of the respondents also said that write off debts is taken as a measure to eliminate default. Therefore the result shows that an organization put much effort to fight default problem but still improvement must be made.

5.4.4 Factors for poor monitoring and supervision of loans

Poor monitoring and supervision of loans leads to default and to greater extent is caused by a lot of factors. Respondents that respond on factors for poor monitoring and supervision of loans argued that 50% of the respondents said Staffing problem, other 30% said that all above (staffing problem and poor road network), 20% of the respondents also said that poor road network. Therefore an organization has to find answers to those factors so as to eliminate/reduce default problem
CHAPTER SIX
SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary
The study revealed that the number of dependant’s affects loan repayment as the loans can be diverted for family obligation. Also it was revealed that there is a default problem as 80% of loan officers agreed to that and also there are delays on payment of loans. The causes of default that are identified were inadequate follow up of loan repayment, loans not requiring collateral, high interest rates, poor supervision on loan utilization, lack of training on use of loans, multiple borrowing, unintended use of loans, and poor sales.

The study also revealed that default affects MFIs as it fails to disburse more loans in the future, loss of interest income and profits, increase operating costs which at the end impacts MFIs sustainability and growth. Measures taken to minimize defaults identified include legal action, outsourcing (external solicitors/ debt collectors) and finally writing off of debts. Also it was identified that staffing problems and poor road network were the main reasons for poor monitoring and supervision of loans.

5.2 Conclusion

Basing on findings of this study the following conclusion is made on the causes and impacts of loan default to MFIs;

Poor supervision of clients on loan utilization and repayment leads to default as clients are not sufficiently supervised on whether they properly use their loans which leads to non repayment and also there are no enough follow up on repayment.

There is lack of enough training before borrowers receive their loans on how to use them and repaying them. This also reduces the possibilities of clients to repay the loans as they lack the necessary skills leading to increasing rate of default and failure to repay and hence their businesses.
There are also a significant number of clients diverting their loans for unintended use such as meeting family obligations, emergency like funeral expenses and so on. Therefore this leads to clients failing to repay their loans on time and hence lead to default.

Loans not requiring collateral security are in a high risk of not being repaid and hence lead to high default rate. This is due to the fact that borrowers are not pressurized and committed to pay as there are not much affected when failing to repay compared with borrowers who are taking secured loans.

Multiple borrowing leads to high rate of default as clients finds difficult of meeting various debt obligations. Usually clients having different loans contracts face various maturity dates and huge amounts of money to repay on which at the end they may not be able to meet their obligations.

Also it was concluded that loan default has impacts on MFIs costs, profitability and interest income. Default lead to increasing operation costs, decreasing profits and interest costs therefore endanger sustainability and growth of MFIs.

5.3 Recommendation

Basing on data collected and the research findings the following are recommended to eliminate loan default:

MFIs helps to create wealth and hence reducing poverty by increasing employment and income, the government should strive to ensure their success and prosperity by formulating policies that creates favorable environment for businesses and financial institutions to operate. Favorable tax laws, lending policies, business environment, and economic environment and so on help businesses to prosper.

The formation of strong solidarity groups is the possible cure of preventing high default. The training and formation stage often covers several sessions. Group members must
clearly understand their roles and responsibilities and fully understand that they are individually signing for the loans of each group member.

MFIs should have clear and effective credit or lending policies and procedures and must be regularly reviewed. The credit supervisor should check with credit officers daily to ensure that policies are followed and the supervisor must respond quickly to solve credit officers’ problems. It makes no sense to have strong policies on paper that are not followed in the field. Next, if credit officers have a specific geographic region, they can visit clients more often; limiting geographic scope reduces time and money wasted traveling from the office to clients’ businesses. More visits enable credit officers to develop relationships in their neighborhoods. There should be timely and close supervision and monitoring of clients; clients having problems on repayment should be identified early and appropriate steps to be taken to ensure repayment.

Yet another way to reduce arrears/default is for MFIs to require the credit officer to visit the client and the client to receive training prior to the disbursement of each loan. It is easy for MFIs to assume that a client or group should get larger loans after each loan cycle, assuming that clients will repay new loans on time if they have repaid past loans on time. However, it is often on the second and third loans that clients fall behind, perhaps because the loan size has grown too big or because the client has begun to take the MFI for granted. The MFI should apply the same rigorous financial and character tests to both new and repeat loans.

Financial incentives can be used to lower the arrears/default rates for individual credit officers. According to Stearns (1997) another strategy that has proven quite effective in finding solutions to default is to design an incentive system for the loan officers that include on-time payments as an important variable. If well designed, the system can motivate credit officers to look for and eliminate the causes of arrears, as well as to meet other program objectives.
If the arrears/default rate rises to such an extent that it threatens the life of the MFI, management must suspend lending to new clients until the Portfolio at Risk (over one day) ratio falls an acceptable level. Credit officers should be more careful with client selection.

In the area of recruitment, the MFIs should recruit enough skilled personnel’s especially credit officers and they should be regularly trained.
Reference


Letenah Ejigu (2009). Performance Analysis of Sample Microfinance Institutions in Ethiopia, University Business School, Panjab University, Chandigarh, India.


Seifu Ali (2002). The Demand for Micro-credit Services in the Afar National Regional State: The Case of Gewane Worker, MSc Thesis, AAU.


APENDIX I: QUESTIONAIRRES FOR CLENTS

This questionnaire is for research study on the effects and causes of loan default to MFIs activities, your response is highly appreciated and treated with confidentiality.

GENERAL CLIENT'S INFORMATION;

SEX……………………….                      MARITAL STATUS…………………………
AGE………………………                        NUMBER OF DEPENDANTS………………

1)   Do you usually pay your microcredit?
    a)  Strongly agree
    b)  Moderately agree
    c)  Disagree
    d)  Strongly disagree

2)   Do you usually pay your microcredit at maturity time?
    a)  Strongly agree
    b)  Moderately agree
    c)  Disagree
    d)  Strongly disagree

3)   Can you default because loan officers fail to come and collect their microcredit at their maturity time?
    a)  Strongly agree
    b)  Moderately agree
    c)  Disagree
    d)  Strongly disagree

4)   Can you default because the loans do not require any collateral?
    a)  Strongly agree
    b)  Moderately agree
    c)  Disagree
    d)  Strongly disagree
5) *Can you default because of higher interest rates?*
   a) Strongly agree
   b) Moderately agree
   c) Disagree
   d) Strongly disagree

6) *Have you ever use business loans for unintended purpose?*
   a) Strongly agree
   b) Moderately agree
   c) Disagree
   d) Strongly disagree

7) *Is there any form of supervision on loan utilization provided by PRIDE Tanzania ltd regarding your loans?*
   a) Yes
   b) No

8) *Is there any form of supervision on loan repayment provided by PRIDE Tanzania ltd regarding your loans?*
   a) Yes
   b) No

9) *Is there any form of training provided by PRIDE*
   a) Yes
   b) No

10) *Has training help to increase business income?*
    a) Yes
    b) No

11) *Do you have other loan(s) from other MFIs apart from that of PRIDE Tanzania ltd?*
    a) Yes
    b) No
- If yes to the above do you face any difficulty on loan repayment as a result of having multiple loans?

a) Yes   b) No
APPENDIX II: QUESTIONAIRRES FOR LOAN OFFICERS

This questionnaire is for research study on the effects and causes of loan default to MFIs activities, your response is highly appreciated and treated with confidentiality.

1) - Are there any loan default in your organization?
   a) Yes  
   b) No

   - If yes, which of the following account for the causes of loan default?
     a) Poor sales
     b) use of loans for unintended purpose
     c) Inadequate supervision and monitoring by loan officers
     d) Multiple borrowing by clients

2) In your opinion, which of the following are the impacts of default on organizations operations?
   a) Inability to disburse more loan in the future
   b) Increasing operation costs
   b) loss of interest income and reducing profits
   c)others, please specify

3) - Are there any measures taken by an organization to ensure timely repayment of loans?
   a) Yes
   b) No

   - If yes to the above, which of the following are the measures taken;
     a) Legal Action
     b) Outsourcing (External solicitor/ Debt collectors)
     c) Write off debts

4) Which of the following are the factors for poor monitoring and supervision of loans?
   a) Staffing problem
   b) Poor road network
   d) All the above