The Relationship between Loan Default and Repayment Schedule in Microfinance Institutions in Ghana: A Case Study of Sinapi Aba Trust

Charles Mensah
Department of Purchasing and Supply, Accra Polytechnic, P. O. Box 561, Accra-Ghana
E-mail of the corresponding author: chalistone@yahoo.com

Gyabeng Raphael, Oppong Dorcas and Baah Yeboah Kwadwo
Department of Banking and Finance, University of Professional Studies, P. O. Box 149, Legon-Accra

Abstract
The activities of Microfinance institutions have increased in its attempt to helping the poor, and one of such activities is microcredit. However, in their attempt to help alleviate poverty, one major challenge that Microfinance face is loan default. This study seeks to examine the relationship between loan default and repayment schedule in microfinance institutions in Ghana with specific case study of Sinapi Aba Trust. The study is an investigative type and only used primary data. Questionnaires were administered to some customers of the Tema and Lapaz branch of Sinapi Aba Trust and were analyzed by means of Ordinary Least Square (OLS) Regression, graphs and tables.
The results indicated that, there was no significant relationship between loan default and repayment schedule in Microfinance institutions. Rather, the study finds significant relationship between interest charged on loans, moral hazard and over-borrowing by customers. Moreover, inability of loan officers to visit borrowers regularly, loans not being backed by collateral were also found to have contributed significantly to loan default among customers.
Keywords: Relationship, Loan Default, Repayment, Microfinance

1.0 Background of Study

According to the United Nations Development Program (UNDP), human development report (2009) the new century declared an action of solidarity and determination to get rid of poverty in the world. In the year 2000, the UN Millennium Declaration gathered various head of states of both rich and poor countries in order to put in measures to eradicate poverty. Besides, the various leaders promised to work together to meet concrete targets for advancing development and reducing poverty by the year 2015 or earlier. According to Consultative Group to Assist the Poor (CGAP 2001), nearly 3 billion poor people lack access to the basic financial services which are essential for them to increase productivity and manage growth of their businesses. As a result of these challenges, many poor people operate very small scale businesses.

Microfinance has evolved as an economic development approach intended to benefit low-income men and women. Microfinance refers to the provision of financial services to low-income clients, including the self-employed, (Ledgerwood, 2000). There are thousands of Microfinance institutions (MFIs) in the world that operate primarily in developing countries. Most of these Microfinance institutions are members of Global Microfinance Networks which aims at supporting partners in the developing countries. Despite the significance of MFIs, certain challenges do work to hamper the realization of poverty eradication. One of such challenge is the issue of loan default. Loan default has been termed the number one killer of MFIs, for the fact that, it is often a leading cause of MFIs Decapitalization and insolvency (Westley, 2005). Loans are considered as risk when any portion of the loan principal is past due. Besides, volatility of loan default in MFIs is higher than of commercial banks since most micro-loans are not secured by collateral in case of default (Rosenberg, 1996). Delinquent loans have serious financial and non-financial implications on the performance of the microfinance institutions in which the repayment schedule is a factor.

In Ghana, Microfinance institutions include Non-Governmental Organizations(NGOs), Savings and Loans Companies, Rural Banks, Credit Unions, Rotating Savings Credit Associations(ROSCAs) and other non-Banking financial Institutions. They all come under an umbrella of Ghana Microfinance Institutions Network (CGAP-2001). Sinapi Aba Trust (SAT) is an autonomous private and not for profit organisation established and duly registered in May 30th 1994 under the company's code 1963 (Act 179) as a company limited by guarantee to support the economically active poor to enhance their lives through microfinance and basic business training. The vision of Sinapi Aba Trust is to become an institution dedicated to the building of a nation under the Almighty God where the strong help the weak and all people have the dignity of providing for themselves, their families, their church and their community". The mission of Sinapi Aba Trust is to serve as a Mustard Seed through which opportunities for enterprise development and income generation are given to the economically disadvantaged to transform their lives. It is involved in the provision of loans to clients' based on an assessment of clients' business operations. There are limits to the amount of loan that a client can obtain at first and in subsequent loan cycles, but in most cases, the nature and size of clients' business, rate of turnover (cash flows) and experience determine the amount of loan that one can obtain at any time. It also engages in the provision of some non-financial services in addition to the financial services.

1.2 Research Problem

It is generally accepted that credit when put into productive use results in good returns. Credit provision is a risky business that may involve fraudulent and opportunistic behavior. Most microfinance institutions are therefore at a disadvantage of information on the borrower's behavior. (Mengistu, 1997). Although the performance of the MFIs has been impressive since their establishment, loan default is a major problem they face and is observed that, their declining repayment rate is a factor. Lending capacity of MFIs is destroyed due to default as a result of the declining flow of repayment (Hunte, 1996). Fischer & Ghatak, (2010) also argued that loan sizes increase as a result of more frequent repayment which eventually leads to over-borrowing. Does loan default have a relationship with the repayment schedule? In an attempt to answer this question, this study tries to analyze the factors behind loan repayment schedule, and the relationship it has with loan default by taking the case of Sinapi Aba Trust.

1.3 Research Objective

General Objectives:

The main objective of the study is to examine the relationship between loan default and repayment schedule in microfinance institutions in Ghana.

Specific Objectives:
- To ascertain the causes of loan default in microfinance institutions.
- To investigate whether clients use borrowed funds for its intended purpose.

1.4 Research Questions

The research sought to address the following research questions:
- What really account for loan default in Microfinance institutions?
- Does loan default have a relationship with the repayment schedule?

1.5 Hypothesis

- Null hypothesis: There is no relationship between loan default and repayment schedule.
- Alternative hypothesis: There is a relationship between loan default and repayment schedule.

1.6 Justification and Significance of the Study

It is expected that the results of the study will help microfinance institutions especially Sinapi Aba Trust, to know the relationship that exist between loan default and repayment schedule. This will enable the company re-strategize their repayment schedule in order to prevent loan default and also some causes of loan default.

2.0 Literature Review

2.1 Definition of micro finance

Microfinance refers to the provision of financial services to low-income clients, including the self-employed. Financial services of MFIs include savings and credit. However, some offer payment and insurance services, (Ledgerwood, 2000).

Theoretically, microfinance encompasses any financial service used by the needy, including those they access in the informal economy, such as loan from a village money lender (Susu). In practice however, the term is usually only used to refer to institutions and enterprises whose goals include both profitability and reducing the poverty of their clients. Microfinance services are needed everywhere, including the developed world.

2.2   Evolution of the microfinance sub-sector in Ghana

The concept of microfinance is not new in Ghana, in the past there has always been the concept of savings and micro loans. Available evidence suggests that the first credit union in Africa was established in Northern Ghana in 1955 by Canadian Catholic missionaries. However, Susu, which is one of the microfinance schemes in Ghana, is thought to have originated from Nigeria and spread to Ghana in the early twentieth century (Asiama & Osei, 2007).   The microfinance sector has become successful due to the various financial sector policies and programmes undertaken by different governments since independence.

In terms of the regulatory framework, rural and community banks are regulated under the Banking Act 2004 (Act 673), while the Savings and Loans Companies are currently regulated under the Non-Bank Financial Institutions (NBFI) Law 1993 (PNDCL 328) (Asiama & Osei 2007)

2.3   Definition of loan default

Peter Kenny in his article defines Loan default as when you fall behind with your monthly repayments. He states that, "if you are late with just one payment, then you are technically classed as delinquent". Thus, default is the failure to pay back a loan. 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.

2.4   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 microcredits. 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.

2.5 Repayment Schedule

Repayment schedule is the time that a borrower of a loan is supposed to pay for it. It thus outlines the schedule that guides the borrower in the repayment process. In fact, the repayment schedule for micro finance institutions is different from that of banks. This is because in Ghana for instance, micro finance loans are not to be granted for period exceeding fourteen (14) months.

2.6   Theories on lending

The main business of most finance institutions is to grant loans and other microcredits to traders and other customers. However, in their attempt to lend, they are faced with the challenge of overcoming information asymmetries. Adverse selection and moral hazard has been the two main outcomes of information asymmetries. In the case of adverse selection, the lender lacks information on the riskiness of its borrowers. Riskier borrowers should be charged higher interest rates to compensate for the increased risk of default than safer borrowers who are less likely to default. Accordingly, safer borrowers should be charged less provided each type can be accurately identified. Since the lender has incomplete information about the risk profile of its borrowers, higher average interest rates are passed on to all borrowers irrespective of their risk profile (Armendáriz & Morduch, 2010).

Moral hazard on the other hand refers to the inability of the lender to ascertain whether the loan granted to borrowers are used for its intended purpose, or that the borrower applies the expected amounts of complementary inputs, especially effort and entrepreneurial skill, that are the basis for the agreement in order to get the loan provided. The borrower may then be less able to repay if these inputs are less than expected. (Ghatak & Guinnane, 1999).

3.0 Research Methodology
3.1 Research Design

The research design is the investigative type. The analysis of information was done in both qualitative and quantitative ways. Cross-sectional data was employed to carry out this research.

3.2   *Population*

In research methods, population is the entire aggregation of items from which samples can be drawn. In this research, the population comprised of clients of Sinapi Aba Trust.

3.3.   *Sampling and Sampling Technique*

One hundred (100) customers of Sinapi Aba Trust were provided with questionnaires to answer. Besides, a random sampling technique was used to derive relevant, reliable and sufficient data from the one hundred (100) clients of Sinapi Aba Trust.

3.4   *Data Collection*

In this study, only primary data concerning loan default and repayment schedule was used. Sources of primary data for this study comprised of customers of Sinapi Aba Trust. This was conducted through questionnaires. The questionnaire was developed based on the research questions and the literature on microfinance, loan default and repayment schedule. The questionnaires used in this study included open-ended and closed- ended questions.

3.5   *Data Analysis*

The data collected from the field were analyzed using regression analysis and charts represented in percentages. With our regression analysis, following Breza, (2006), we adopted the model below:

$$LD_i = \beta_0 + \beta_1(RS_i) + \beta_2 X_i + \varepsilon_i$$

Where:
LD_i = *loan default for individual i*
RSi = *Repayment Schedule for individual i*
X_i = *Vector of control variables*
X_i Includes:
Li = *Interest charged on loan*
Mi = *Moral Hazard*
Oi = *Over borrowing*
Ni = *Number of dependents*
Gi = *Gender*
ε_i = *error terms*
LD_i was measured by the number of times borrowers defaulted.

RS_i was measured by the length of time given to borrowers to repay the loan. It included dummy variables of 1-4months, 5-9months and finally 10-14months. A negative sign is however expected at the end of the results.

I_i was measured by the amount of interest charged on the loan amount given to borrowers. A positive sign is expected at the end.

M_i was measured by looking at those customers who use loans for funerals, marriages, etc. other than the reason stated in the loan agreement. We expect a positive sign.

O_i was measured by looking at those who took other loans in addition to that of SAT and a positive sign is expected at the end of the results.

N_i was measured by the number of people who are being taken care of by the customers who take the loans. We expect a positive sign at the end of the results.

3.6 Limitations of the Study

The research scope should have covered the entire Microfinance institutions in Ghana to give adequate grounds for generalization of the research findings but due to limited time frame the research was limited to Sinapi Aba.

4.0 Data Analysis, Presentation and Interpretation
4.1 Summary Statistics
Table 1: Summary Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Default	100	1.67	4.00	2.4383	.43722
Interest paid on loan	100	12	2000	204.04	323.511
Moral Hazard	100	1	4	2.71	.935
Over Borrowing	100	1	4	2.11	1.034
Gender of respondent	100	0	1	.48	.502
Number of dependents	100	0	3	1.02	.816
Repayment	100	3	14	7.04	3.008
Valid N (list wise)	100				

Source: Field Survey. June, 2013

Table 1 shows the statistical summary of both the dependents and independent variables of the study. Default measured by the number of times borrowers default has a mean of 2.4383 times. It is also clear from the table that the standard deviation was 0.43722 and the minimum and maximum values were 1.67 and 4.00 times respectively. The low range of default (2.4383 times) supports its low standard deviation of 0.43722 which means that there was a low variability of default. The interest charged on the loans had a mean of GH₵204.04 which is measured by the interest on loans monthly. The standard deviation showed a figure of 323.511. The minimum and maximum interests were GH₵12 and GH₵2000 respectively. Moral hazard also had a mean of 2.71 indicating that the majority of clients do not agree that they diverted the loans while minimum and maximum figures were 1 and 4 respectively. Standard deviation was 0.935 showing a low dispersion.

The results above also indicate that over borrowing had a mean of 2.11 times as measured by the extent of additional loans that the borrowers take. It has a minimum of 1 and maximum of 4. Standard deviation measured was 1.034. Number of dependents also had a mean of 1.02 persons whereas the minimum and maximum had 0 and 3 respectively. Standard deviation measured was 0.816.

The mean repayment schedule was 7.04 months as measured by the length of time given to borrowers to repay their loans. The minimum and maximum values were 3 and 14 months respectively and with a standard deviation of 3.008.

4.2 Regression Results
Table 2: Regression Results

Variable	Coefficient	Std. Error	t-ratio	Sig.
Constant	1.344	0.211	6.368	0.000
Interest	0.293	0.107	2.733	0.008
Moral Hazard	0.103	0.045	2.279	0.025
Over Borrowing	0.111	0.039	2.837	0.006
Gender of respondents	0.061	0.076	0.797	0.428
Number of dependents	-0.005	0.018	-0.259	0.796
Repayment Schedule(5-9months)	-0.004	0.035	-0.127	0.899
Repayment Schedule(10-14month)	-0.037	0.141	-0.265	0.796
Regression Diagnostics Observation 100 R- Square 0.305 Adjusted R^2 0.252 F-Statistic 5.765 (0.000)				

Source: Field Survey. June, 2013

4.2.1   Gender of Respondents:

The gender included in this model was a dummy variable with male as the reference point. It shows that the females were defaulting more than the males. However, this variable does not have any significant effect on loan default.

4.2.2   Number of Dependents:

The regression result once again shows that the number of dependents has no significant effect on loan default with a t-statistic of -0.259.

4.2.3   Repayment schedule:

This is the main independent variable of interest in our study. It is a dummy variable with 1-4months as the reference point. The repayment schedule of 5-9months has a coefficient of -0.004 which suggests that the repayment schedule ranging from 5-9months were defaulting less than from 1-4months whilst that of 10-14months were found defaulting less than 1-4moths also with coefficient of -0.037. However, both repayment categories have a t-statistic of -0.13 and -0.27 respectively which shows that the repayment schedule has no significant effect on loan default in microfinance institutions, though the expected negative sign was recorded. Therefore, researchers accept the null hypothesis which states that there is no relationship between loan default and repayment schedule and reject the alternative hypothesis of our studies. However, this is consistent with the work of Field & Pande, (2007) who concluded that the repayment schedule in microfinance institutions has no effect on loan default.

4.2.4   Interest:

The regression results shows that the interest charged on the loans has a positive effect on loan default in microfinance institutions. The coefficient of 0.293 suggests that when the microfinance institutions increases the interest charged on the loan by GH₵1, loan default increases by GH₵0.293. This variable is significant with a t-statistic of 2.733 at 1 percent significant level. This implies that, default increases when interest rates charged on microcredit are also increased by the microfinance institutions. This is because their total amount to repay becomes higher and so are unable to pay at their maturity time and vice versa.

4.2.5 Moral Hazard:

The regression once again indicates that moral hazard has a positive relationship with loan default in microfinance institutions. It has a coefficient of 0.103 which suggest that an increase in moral hazard by 1 percent leads to 0.103 percent increase in loan defaults. The variable is significant with a t-statistic of 2.28 at 5 percent significant level. This implies that, when customers use the loans for different purposes especially unproductive purposes other than those stated in the loan agreement, they are unable to recoup the money and so unable to repay at their maturity time thereby increasing default and vice versa. This is also consistent with the work of Ghatak & Guinnane, (1999) who concluded that when moral hazard rises, borrowers are less able to repay loans.

4.2.6   Over -Borrowing:

Taken additional loans were also found to have a positive relationship with loan defaults in microfinance institutions. It has a coefficient of 0.111 which suggests that, 1 percent increase in over-borrowing leads to 0.111 percent increase in loan default. It has a t-statistic of 2.84 at 1 percent significant level. This implies that, when customers take additional loans aside those granted by SAT at the same time, they are unable to repay all these microcredits at the same time and so default increases and vice versa.

4.2.7 Robustness of Regression Model

The goodness of fit of the regression model is determined by the value of the F-test. It is the way of determining whether our model is a better predictor of our outcome. It has a value of 5.755 at 0.01 significant level which shows that our model is a better predictor of the outcome. Also, the Adjusted R-square shows the explanatory power of our regression model. In the table above, it has a value of 0.252 which explains that, only 0.252 variations in default is explained by the independent variables.

4.3 Demographic of Respondents
Figure 1.0 Gender of Respondents
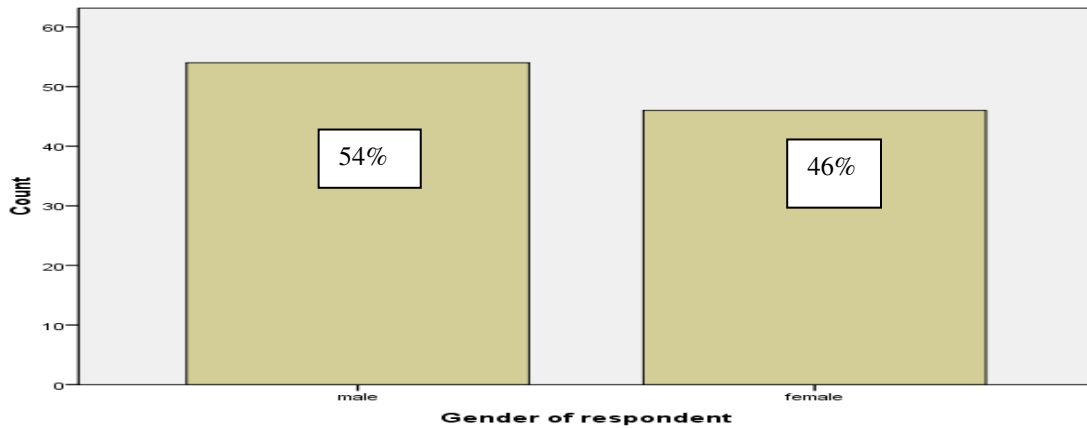
Source: Field Survey. June, 2013.
The diagram above in figure 1.0 shows the gender distribution of the respondents, with male customers representing 54 percent of the entire population of 100 and the 46 percent representing female customers.

4.4 Marital Status of Respondents
Figure 2.0: A graph showing the marital Status of Respondents
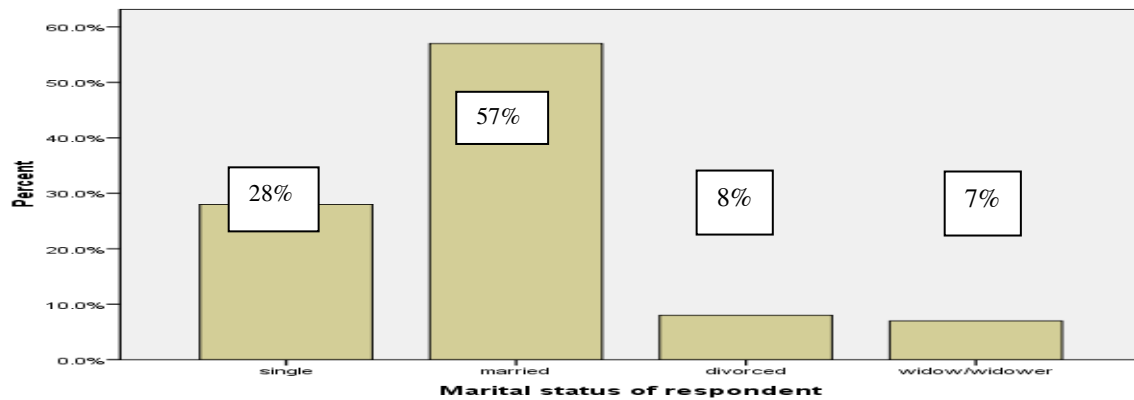
Source: Field Survey. June, 2013.
Respondents were asked about their marital status, and the above graph represents their responses. 28 percent of the respondents were single, 57 percent were married, 8% of respondents divorced and finally 7% representing widows/widowers.

4.5 Number of Dependence of Respondents
Figure 3.0 Number of dependence
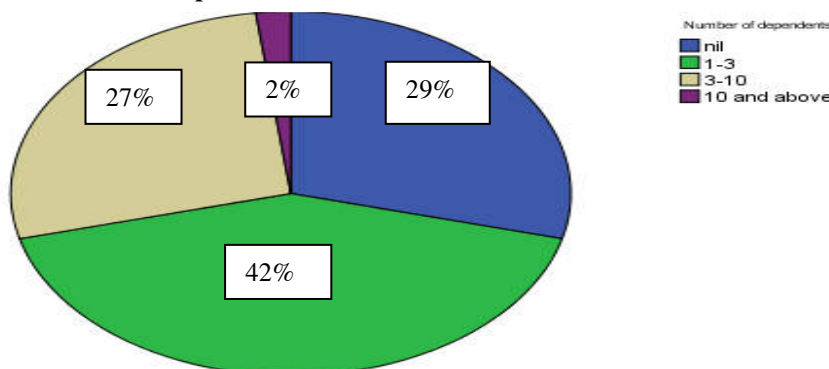
Source: Field Survey. June, 2013.

From the diagram above, 29 percent of the respondents had no people depending on them, between 1-3 dependents was represented by 42 percentage of the respondents, 3-10 dependents represented by 27 percent and 10 and above had 2 percent representing them.

4.6 Extent of agreement and disagreement of whether respondents take other loans in addition to SAT
Figure 4.0 Extent of agreement and disagreement of whether respondents take other loans in addition to that of SAT
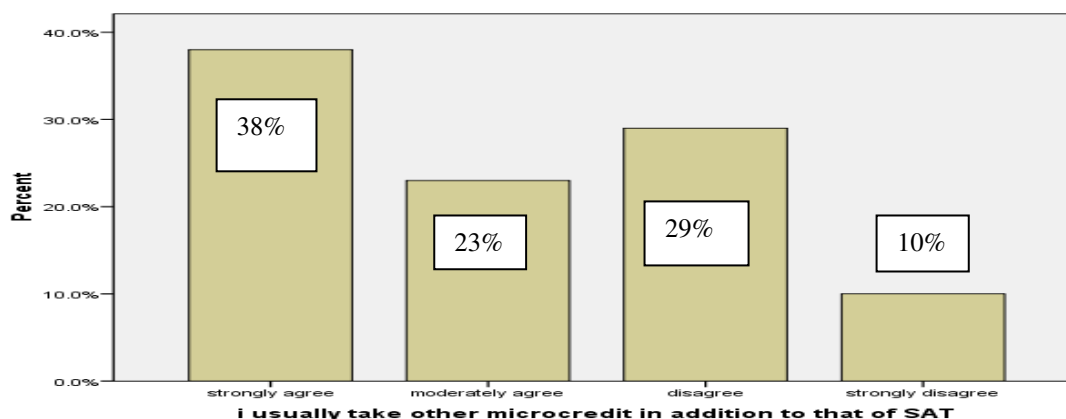
Source: Field Survey. June, 2013.

The chart above shows that most of the respondents also took other credits from other microfinance institutions, the largest representing 38 and 23 percent representing strongly agree and moderately agree respectively. 29 percent disagreed and the rest strongly disagreed representing 10 percent.

4.7 The extent of agreement and disagreement of whether respondents repay their microcredit
Figure 5.0: Extent of agreement and disagreement of whether respondents repay their microcredit
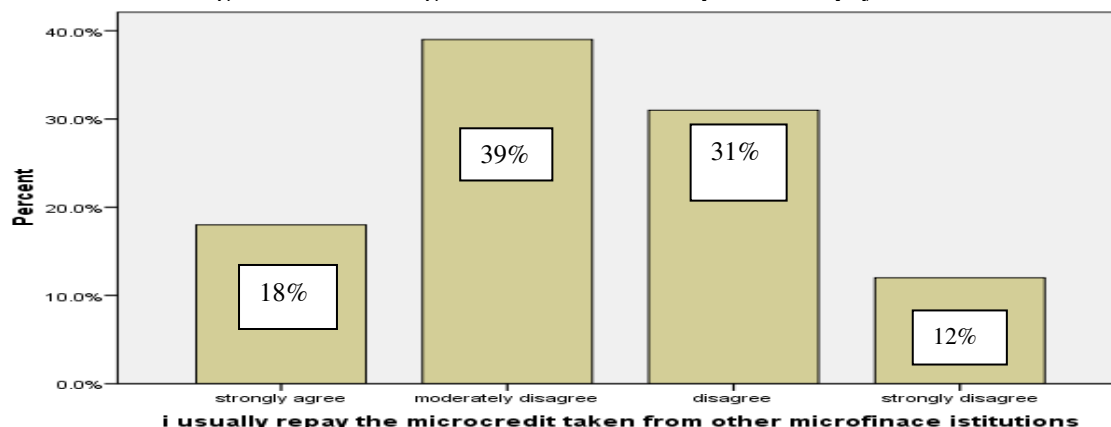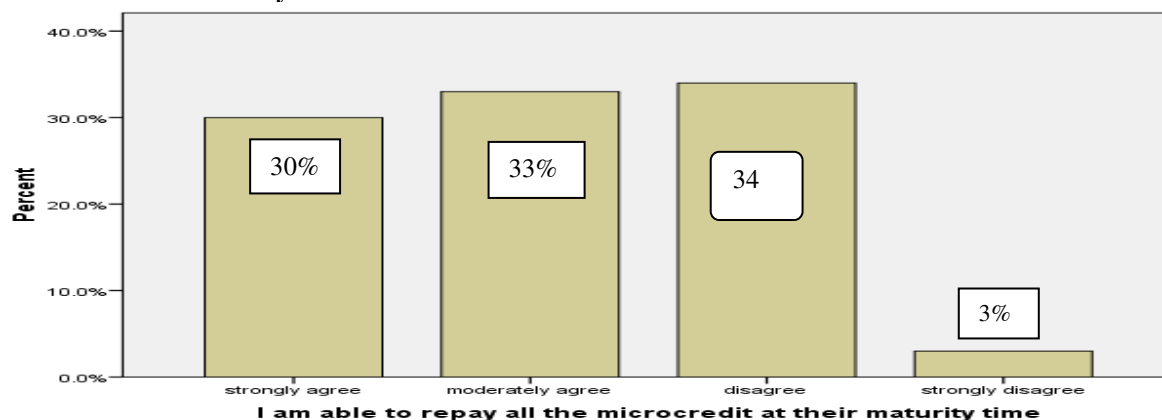

Source: Field Survey. June, 2013.
Figure 5.0 above shows that some of the customers were defaulting and that represented a total of 43 percent, with 31 percent disagreeing to the fact that they usually repay back the credit while 12 percent strongly agreeing to the same. On the other hand, a total of 57 percent answered otherwise with 18 and 39 percent representing strongly agree and moderately agree respectively.

Table 4.8: The extent of agreement and disagreement of whether respondents repay microcredit at their maturity time.
Figure 6.0: A graph showing the extent of agreement and disagreement of whether respondents repay their microcredit at their maturity time
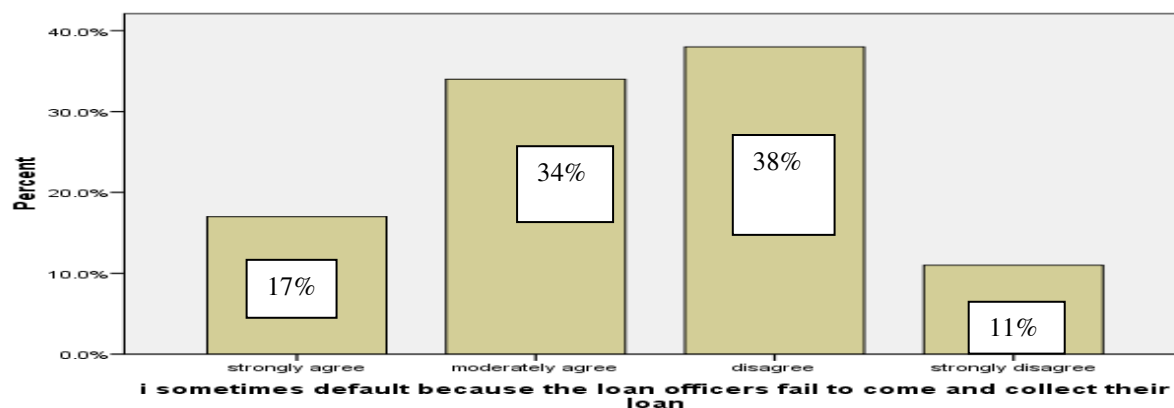

Source: Field Survey. June, 2013.

The graph above shows 30 percent of the respondents agreed strongly that they were able to pay and 33 percent also agreed moderately. On other hand, 34 percent also disagreed and finally 3 percent strongly disagreeing to the questionnaire. The above responds then means that, in all 63 percent of the entire population that is the customers of SAT were being able to repay all their microcredits at their maturity times whiles 37 percent also saying that they were unable to repay.

4.9   Some Causes of the Loan Default

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

Figure 7.0: A graph showing the extent of agreement and disagreement of whether respondents default because loan officers fail to come and collect their microcredit at their maturity time.
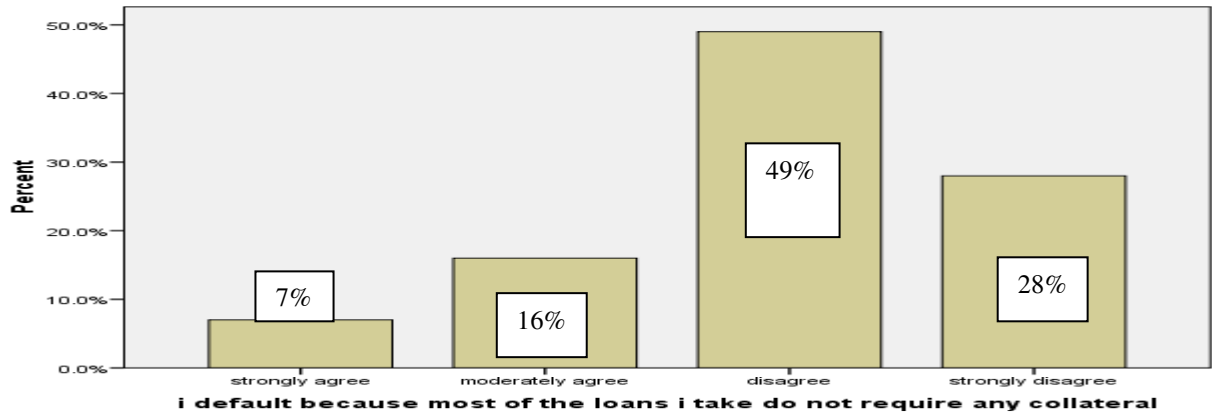

Source: Field Survey. June, 2013.

The above graph shows in percentage that 17 percent of customers strongly believe that loan officers failure to come to collect loans leads to their default whiles 34 percent also somehow agreed to the same assertion disagreed strongly. So in all it can be said that 51 percent agreed to the fact that they fail to repay loans when loan officers themselves refuse to come collect the loans by themselves.

4.10: Does respondents default because the loans do not require any collateral
Figure 8.0: A graph showing the extent of agreement and disagreement of whether respondents default because the loans do not require any collateral
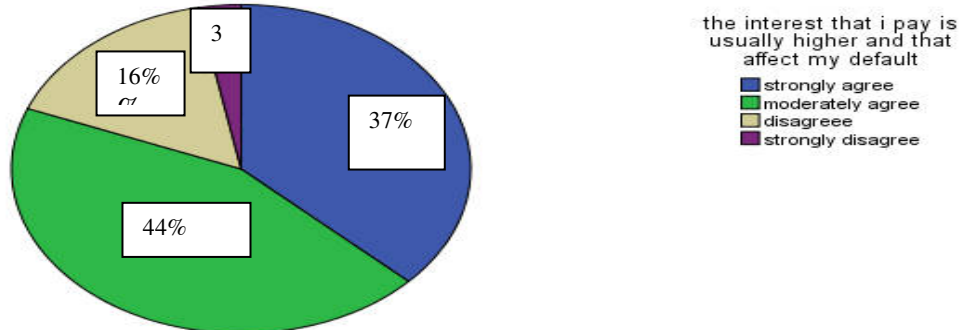

Source: Field Survey. June, 2013.

Figure 8.0 shows that 7 percent of the respondents strongly agreed to the fact that they defaulted because most of the loans they take do not require any collateral whiles 16 percent also agreed moderately to the same question. However, some of the respondents also disagreed and that 49 percent disagreed whiles 28 percent in fact strongly disagreed. Though in all it appears that majority disagreed but the point that 23 percent also agreed cannot be ignored.

4.11 Does respondents default because of higher interest rates?
Figure 9.0: A graph showing the extent of agreement and disagreement of whether respondents default because of higher interest rates.
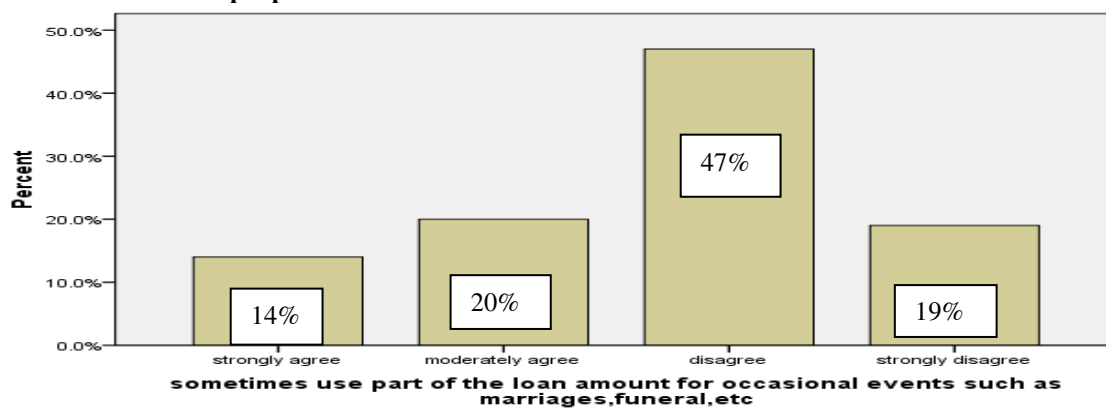

Source: Field Survey. June, 2013.

The pie chart above is figure 9.0 also was to find out whether interest charges on loans also account for default. Besides, it shows that 37 percent strongly agreed to interest rates being higher and so account for their default whiles 44 percent also agreed moderately. Despites, the fact that some agreed does not means all did, some respondents also thought otherwise and that 16 percent disagreed and finally 3 percent also disagreeing strongly. This therefore means that 81 percent of the total respondents agreed that interest charge is also a factor to default of loans.

4.12 Diversions of Loans from Their Intended Purposes
Figure 10.0: A graph showing the extent of agreement and disagreement of whether respondents divert the loans from its intended purposes
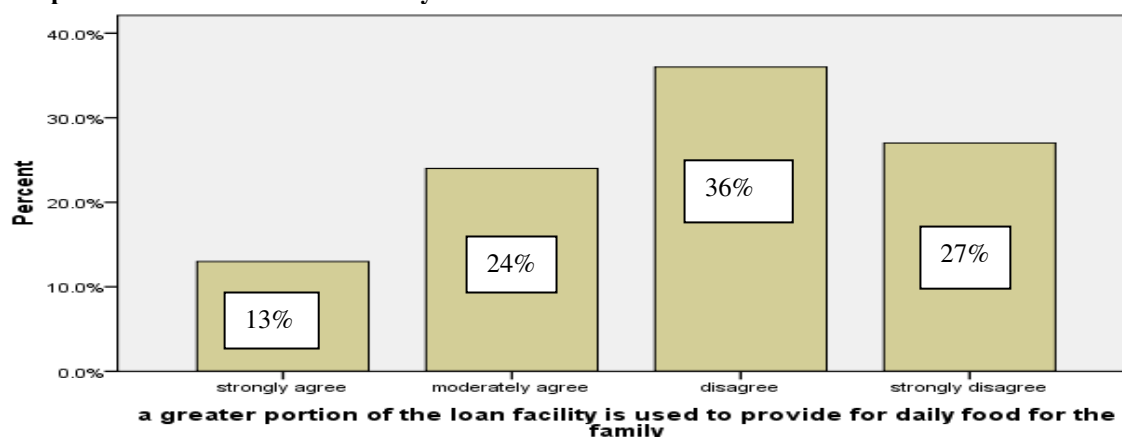

Source: Field Survey. June, 2013.
The graph above shows that 14 percent of the respondents strongly agreed to the fact that they were using part of the loan amount for occasional events such as marriages, funeral, etc. whiles 20 percent also moderately agreed. It also shows that 47 percent of the respondents disagreed and 19 percent also strongly disagreeing.

4.13: The extent of agreement and disagreement whether respondents use greater portion of loans to feed the family
Figure 11.0: A graph showing the extent of agreement and disagreement of whether respondents use greater portion of loans to feed the family

Source: Field Survey. June, 2013.
The bar graph above shows that 13 percent of the respondents strongly agreed that a greater proportion of the loan facility are used in providing daily food for the family whiles 24 percent also agreed moderately. 36 percent on the other hand disagreed and the remaining 27 percent also strongly disagreed. It is therefore clear that some customers were diverting the loans from their intended purposes.

5. Conclusion and Recommendation
5.1 Summary of key findings
The research revealed that both gender and the number of dependents had no significant effect on loan default in microfinance institutions though the female were defaulting more as compared to the males. Also, repayment schedule which happens to be the main independent variable had no significant relationship with loan default from the study. However, those customers given less repayment time defaulted more than those given longer period of time. Meanwhile, interest rates charged on loans, moral hazard and customers who took additional loans to that of Sinapi Aba Trust had a significant positive relationship with loan default. The study also revealed that some borrowers diverted the loans from their intended purposes. 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.

5.2   Conclusion
Based on the research conducted to examine the relationship between loan default and repayment schedule in microfinance institutions in Ghana, it was found out that, the repayment schedule had no significant effect on

loan default. The test for the Null hypothesis thus holds, that is "there is no relationship between loan default and repayment schedule".

5.3 Recommendations

Based on the findings that our study revealed, the following recommendations have been suggested to prevent loan defaults:

- Collateral should be provided against loans by borrowers in order to motivate them to repay back the loans.
- Microfinance institutions should motivate client officers to spend more time to visit clients and finishing client's files in reasonable time. Institutions should periodically organize award ceremonies for clients who diligently pay their installments on time, to encourage others to emulate them.
- There should be proper screening before loans are granted to them (borrowers).
- Penalties should be applied to past due or unpaid loans to discourage defaults. It can be in the form of refusal of new loans to borrowers who default.

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