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Loan Utilization and Repayment Practices of Rural Microfinance Clients: The Case of Wereilu District-Amhara Regional State of Ethiopia

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Abstract
The main objective of the study is to assess loan utilization and repayment behavior of rural microfinance clients. It particularly provides a descriptive assessment on five themes: socio-economic characteristics, loan utilization behavior, sources of financial for loan repayment and perceived delinquency/default reasons of clients as well as capacity of the lending institution. To this end, a survey questionnaire was administered to a sample of 200 rural microfinance clients. For data triangulation, the study incorporated focus group discussion and in-depth interview methods. The study finds that clients are composed of adult working age and less educated individuals largely dependent on vulnerable smallholding agriculture. In addition, the loan packages are somewhat 'directed type' and supply-driven. Clients' borrowing purpose vis-à-vis actual loan utilization deviates to a certain extent, suggesting loan diversions. Clients have also undiversified and risky financial sources to repay MFI loan. Perceived reasons for loan delinquency/default are also linked to seasonal income variability, ACSI funded-project failure, loan diversions and the lending institution's defects. The group lending modality tends to screen out the poorest of the poor. Peer pressure is effective to ensure timely 'loan repayment', but it is weak to guarantee proper 'loan utilization' per se. The loan product design is homogeneous and inflexible to meet target market needs. Further, the lending institution's 'loan utilization monitoring' incurs higher institutional transaction cost and information asymmetry than 'loan repayment monitoring' does. On top of that, clients bear transaction costs in terms of absenteeism penalty fee, frequent long-distance travel and regular group meeting. Last, the lending institution inclines to financial intermediation (minimalist) rather than both financial intermediation and social intermediation (integrationist). Therefore, the lending institution and policy makers should pay attention to demand-driven loan packages, rural microbanking service, intra-group microinsurance, reforming client-screening policy and integrating financial intermediation with social intermediation.
Keywords: Rural microfinance, Repayment, Loan utilization, Financial source, Default/delinquency,Institutional aspects, ACSI, Ethiopia

1. Introduction

Background

Like most of its Sub-Saharan neighbors, Ethiopia is an agrarian society ranking 169 out of 177 nations in Human Development Index (UNDP, 2002). The country suffers from deep-rooted poverty where 14 million people, nearly 20 % of the total population, need food aid. Moreover, 45 % of the estimated population lives below absolute poverty (Gete, 2003). Agriculture remains the backbone of the country's economy in terms of total employment, export earnings and Gross Domestic Product (GDP). However, agriculture perpetuates low living standard of the majority of the rural population (Brune, 1990).

Different authors have explained reasons for rural poverty in Ethiopia. Gete (2003) stated that inappropriate policy, periodic drought, and relentless war have been responsible to the low economic performance. Similarly, Dejene (1990) explained that the policy biases (namely priority for large-scale farms, inadequate agricultural technology and inputs dissemination, absence of participatory decision-making and women exclusion from development programs) are the root causes of rural poverty. In addition, Brune (1990) stated that rural underdevelopment is sustained because of low agricultural productivity, agricultural export dependency, unsuitable agricultural technology importation, poor infrastructure and unskilled human resource.

On top of that, *weak rural credit market* has immensely contributed to rural poverty perpetuation in Ethiopia (Brune, 1990). Therefore, financial influx from outside agriculture is vital to deliver particularly agricultural credit (Soles, 1993) since the sector cannot finance its own growth in developing countries (Brune, 1990). In Ethiopia, the formal rural credit was emerged by specialized agricultural lending institutions or parastatal organizations. The objective of those institutions was to stimulate traditional farmers in utilizing productive inputs and modern technologies (Hailu, 2005). Besides, Soles (1993) explained that agricultural credit institutions are to liberate farmers from exploitative individual moneylenders. However, the credit through specialized lending institutions failed to promote grass root agricultural development. This was because of weak institutional capacity, poor repayment performance, collateral requirement and credit misallocation (Hailu, 2005).The intervention destroyed repayment culture that borrowers viewed credit as 'charity' (Hailu, 2005; Wolday, 2006). On the other hand, credit programs of non-governmental organizations (NGOs) were unsuccessful to meet the credit demand of the rural poor because they had short-term and mixed objectives.

In 1990s, the government of Ethiopia liberalized the financial market and formulated strategies for the smooth functioning of rural economies. Pursuant to Agricultural Development Led Industrialization (ADLI) strategy, the government has facilitated the emergency of microfinance institutions (MFIs) (Getaneh, 2002). In accordance with Article 55(1) of the Constitution of Ethiopia, Proclamation No.40/1996 was promulgated to guide the licensing and supervision of microfinance business. The proclamation has provided a legal regime to microfinance institutions' activities within the financial and monetary policies of the country (FDRE, 1996). Following the Proclamation, there were 23 MFIs established to operate in Ethiopia (Wolday, 2006). Amhara Credit and Saving Institution (ACSI) [1] is one of the leading government-owned microfinance institutions in terms of capital, age, scale of operations and staff number (ACSI, 2004; Tsegaye, 2005). Currently, the institution provides different types of financial services, including credit, saving, money transfer and pension-fund management. It is the sole formal microfinance institution serving the rural community of Wereilu District. Its *principal objectives* are to promote economic activities of the productive rural poor, alleviate poverty by giving priority to rural and remote community(particularly women), increase clients' income and asset position and ensure its financial and operational sustainability (ACSI, 2004).

Problem statement

Microcredit, as an effective policy instrument in improving the welfare of the rural poor, gains wider acceptance among policy makers, microfinance clients, government officials and donors worldwide. In this respect, formal MFIs have played a central role. MFIs provide microcredit to the poorest of the poor with subsistence livelihood in developing countries (La Torre & Vento, 2006). The institutions use innovative approaches to deliver microcredit to the un-bankable citizens by the conventional banking system. The innovative approach consists of group lending modality, progressive small loans, regular compulsory saving, regular repayment schedules and social collateral (Johnson & Rogaly, 1997).

There is, however, a growing concern within microfinance circle that MFIs focus on commercial objective rather than poverty alleviation objective. Until the half of 1990s, microfinance actors hardly stressed on sustainability concept because their primary goal was poverty alleviation (Charitonenko & Rahman, 2002). Since then, MFIs have gradually elevated the agenda of sustainability to the scene. This explicates that MFIs of developing countries are tempted to use 'sustainability first' catchphrase because of either learning in microfinance market or pressure from neoliberal donors. In fact, they have increasingly tested various methods in improving institutional sustainability. Ledgerwood (1999; 205) discusses that microfinance institutions use myriad performance indicators-"portfolio quality, productivity, efficiency, financial viability, profitability, productivity, leverage, capital adequacy, scale, outreach and growth"-to evaluate sustainability. However, none of these indicators can guarantee clients' viability. Social visionaries argue that the move towards institutional sustainability has overshadowed MFIs social objective (Charitonenko & Rahman, 2002). They dispute the plethora of 'profit' and 'commercial' orientation. With such orientation, MFIs tend to confine to clients with good repayment potential, reach areas relatively cheaper and unserve the poorest of the poor. On top of that, MFIs would charge high interest rate to achieve operational and financial sustainability (*Ibid*, 2002).

Alternatively, some authors and practitioners advocate a 'hybrid approach'. In view of that, MFIs are entrusted to achieve both poverty reduction and institutional sustainability goals (Johnson & Rogaly, 1997). Charitonenko & Rahman (2002) argue that MFIs should balance commercial and social objectives to remedy mission drifts. MFIs are exposed to "social mission drift" in the absence of clear target market and monitoring system ; they are vulnerable to "commercial mission drift" unless managing themselves as a business and setting high interest rates (*Ibid*,2002;45).

'Microfinance schism debate', are the dual goals of MFIs mutually supportive or conflicting? (Morduch, 2000), has attracted the interest of researchers. Theoretical debates demonstrate divergent views, hitherto. The intermediary perspective prioritizes institutional sustainability while analyzing the effect of MFI on clients' viability. Quite the opposite, the beneficiary perspective claims the need to underscore whether microfinance is beneficial to clients. Ask, Wiig & Sigvaldsen (1997) explained that institutional sustainability could not guarantee clients' viability. In recent times, many microfinance researchers have reiterated the issue of institutional sustainability in published journals and so. In comparison, this study attempts to analyze MFIs credit market virtually from the client perspective. On top of that, the issue at hand is the least researched topic. Studying loan utilization and repayment practices, therefore, helps to draw implication pertaining to not only clients' viability but also MFIs sustainability. To reiterate, the study aims at identifying *loan utilization behavior*, *financial sources for repayment*, *delinquency/default reasons, and socio-economic status of clients as well as institutional factors (MFI aspects)* which are fundamental to clients' viability in microcredit market.

The first inquiry is that loan-taking purpose vis-a-vis actual *loan utilization behavior* of clients may

[1] ACSI is organized as a share company pursuant to Proclamation No. 40/1996. The incumbent ruling party of Amhara Regional State establishes ACSI using a political endowment fund.

deviate in MFI credit market (Johnson & Rogaly, 1997). Empirical evidences (for example in Ethiopia) show that clients often divert loans for unproductive activities (see Belay, 2002; Getaneh, 2002; Borchgrevink et al., 2005). Nevertheless, there are mixed findings whether loan diversion has unwanted effect on clients' viability. Next, MFIs use stringent measures (such as peer pressure, field workers and eventually legal actions) to secure loan repayment, irrespective of clients' circumstances. Poor clients are, however, vulnerable to risky *financial sources* in paying MFI debts back. Wiig (1997) stated that clients' exposure to risky financial sources (such as individual moneylenders, sales of valuable assets, etc.) exacerbate downward spiral poverty. To the worst, rural clients may be prone to *default/delinquency* because of either failure to use funds for productive purposes, failure of the investment or clients'refusal to repay (Sanderatine, 1983).

The fourth issue of inquiry involves *capacity of lending institutions* that could have deterrent effect on a loan utilization and repayment behavior. Ledgerwood (1999) explained that loan-product design, credit delivery modality and monitoring systems of MFIs need to be designed according to the needs of clients. Clients may viably utilize and repay loans if MFIs successfully design financial services. For example, evidence in Ethiopia by Getaneh (2005) indicated that 'institutional rigidity' of ACSI has constrained investment and income-generation of clients. Similarly, MFIs often lack qualified personnel that have both social development and financial management background (Ledgerwood, 1999). Employees' commitment, knowledge of local culture and altruistic behavior are uniquely imperative in microcredit services of MFI. Lastly, *socio-economic characteristics* of clients are indispensable per se. Studies show that gender, age, educational level, religion, asset position and occupation affect practices of loan utilization and repayment. Ledgerwood (1999) stated that successful microfinance schemes often begin with understanding the characteristics of target groups.

Thus far, ACSI has not been a subject of research even though it commenced its financial service ten years before. To the extent of author's knowledge, empirical evidence is virtually non-existent concerning loan utilization and repayment practices of ACSI clients in Wereilu District.

Therefore, the central research questions this study seeks to answer include the following. What are the socio-economic characteristics of clients? How is loan utilization practice of clients? What financial sources do clients utilize to repay MFI loan? What are the perceived reasons for clients' delinquency/ default? How do institutional aspects of ACSI affect loan utilization and repayment?

2. Data and method

This study combined qualitative and quantitative approaches to assess how rural clients utilization and repayment microcredit. It used a quantitative approach having descriptive purpose. Kothari (2004) states that descriptive research can only report what is happening; it has no control over variables. Qualitative approach is included to supplement the quantitative approach (Gabrielian, 1999) because qualitative approach helps to assess opinions of respondents using own intuition (Kothari, 2004). Generally, the study relied on primary sources of data.

Sampling design. The paper designed sampling techniques that would instill triangulation of data sources. Gabrielian (1999; 169) viewed that triangulation is "the act of bringing more than one data source or more than one perspective to bear on a single point". The study, therefore, exploited a combination of scheduled questionnaire, in-depth interview, and focus group discussion methods. To the collect data via questionnaire, the research used simple random randomly in choosing four rural *kebelewoch*[1] (i.e. *Kebelewoch* of Wereilu District). Then, it prepared a sample frame of active- and ex-clients separately from ACSI roaster, files containing lists of active- and ex-clients. The purpose of incorporating ex-clients is to obtain realistic information about loan diversions, reasons of defaulting and problems with the lending institution. It is expected that ex-clients feel un-frustrated or loss nothing by releasing honest information. Hence, a sample size of 40 ex-clients was selected using simple random sampling technique. In the same way, 160 active-clients were chosen by means of simple random sampling. To this end, the study made use of random number-table to pick active- and ex-clients randomly. Therefore, it included a total sample size of 200 valid responses. In summary, the questionnaires covered socio-economic characteristics, loan utilization behavior, financial sources to repay loans, reasons for default and institutional aspects.

In-depth interviews were also conducted with ACSI employees. Of the nine ACSI employees at Wereilu District, the coordinator and two field-workers were interviewed. The interview gathered information concerning lending modalities, loan-product design, monitoring mechanisms and the overall loan utilization-repayment challenges. In addition, *focused group discussions* (hereafter FGD) were carried out with loan group leaders. The study considered four discussion groups having six members per group: Two discussion- groups were organized for female group leaders and the remaining two discussion groups comprise of male group leaders. Female and male group leaders were interviewed separately to build confidence and openness among the focus group participants. The group discussion was aspired to collect 'community level' opinions. To this end,

[1] *Kebelewoch* refers to the lowest levels of government structure (or sub-divisions of a given district).

the study formulated semi-structured questions for FGD participants with respect to economic characteristics of clients, loan utilization behavior, sources of finance for repayment, perceived delinquency/default reasons and institutional constraints.

Data collection procedure. The survey questionnaire principally contains closed-ended questions. Further, the questionnaire was translated in to Amharic language-the mother tongue of respondents. Expecting that many respondents are uneducated, the study arranged 'scheduled questionnaire' that allows enumerators to fill out the questionnaire themselves. Kothari (2004) elaborates that researchers usually prefer scheduled questionnaire if the target respondents are illiterate. He added that this technique has more reliable results and lower non-response rate. In the same token, the semi-structured questions of both in-depth interviews and FGD were translated in to Amharic language. Finally, the field administrator (the researcher) conducted in-depth interviews and FGD whereas the enumerators filled the scheduled questionnaire.

Methods of data analysis. The study developed a mixture of quantitative and qualitative analysis. The quantitative data were derived from the survey questionnaire and were analyzed through descriptive statistical tools. The descriptive statistical technique contains simple average, percentage, tabulation and graphs. Qualitative information collected by means of FGD and in-depth interviews were analyzed intuitively.

3. Result

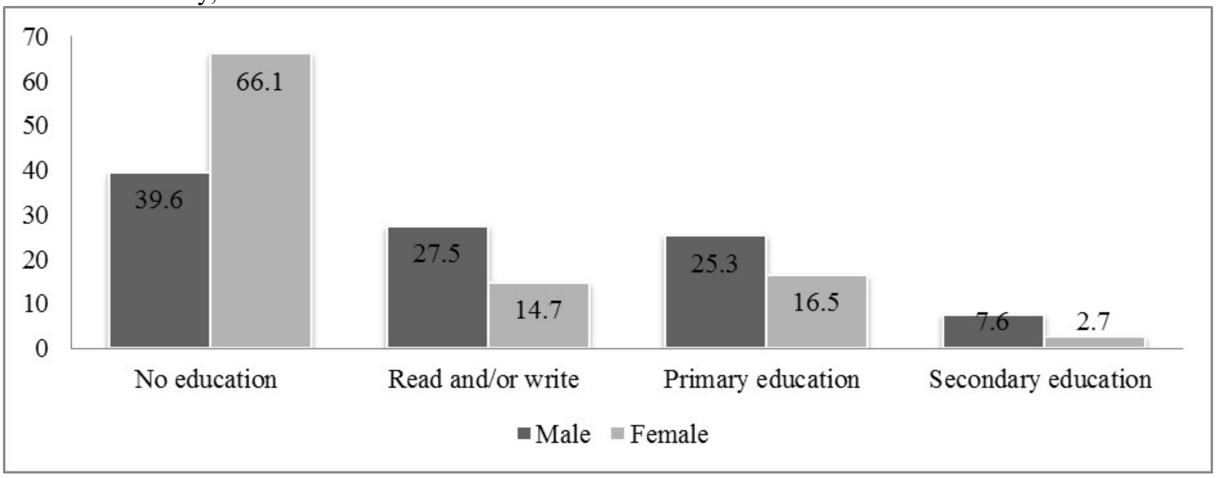
Socio-economic characteristics of clients

Presenting socio-economic condition of clients allows us to recognize microcredit usage and repayment behavior. Besides, microfinance institutions would niche credit services according to the characteristics of clients. This section, therefore, describes the socio-economic characteristics of ACSI clients.

The *socio-demographic* variables including gender, age, religion, and educational level of respondents are analyzed. From 200 valid respondents, female clients constitute 55% in spite of the fact that male clients account 45%. Besides, the average of clients is 40 years. When the average age of female and male clients is compute separately, it is estimated to be 38 and 43 years respectively. Concerning religious affiliation of clients, 60% of the respondents are Ethiopian Orthodox Christians and the remaining 40% belongs to Sunni Islamic religion. Figure 3.1 describes the educational status of rural clients. Generally, two-third of the respondents has never attended either primary school education or secondary school education. Clients' educational background varies with gender. Approximately 66% of female clients have 'no-education'. In contrast, 40% of male clients have 'no-education'. Further, 15% of female clients and 28% male clients can only 'read and write'. In general, microfinance clients are largely illiterate (either 'no-education' or 'read and/or write').

Figure 3.1: Educational level of rural microfinance clients (percentage)

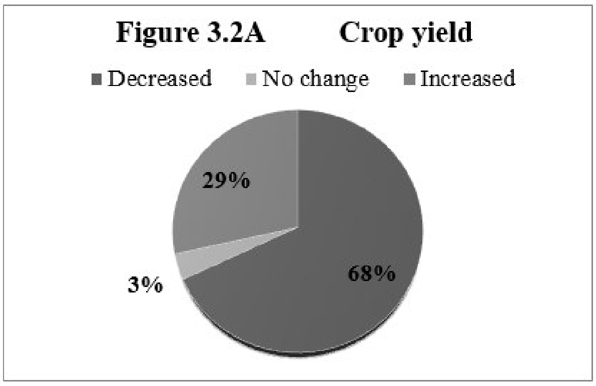
Source: Own survey, 2007

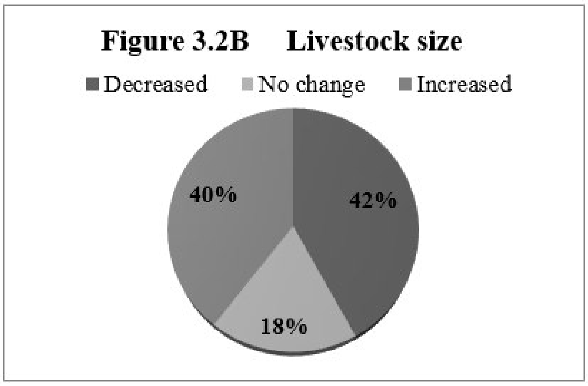


Land, crop and livestock are valuable assets of smallholder farmers reflecting their economic status. The study, therefore, evaluates the *economic characteristics* of clients, such as landholding, crop yield, livestock size and occupation. It shows that the average landholding by of a client's household is roughly 4.1 *'Timad'*[1]. This noticeably indicates that landholding per household is smaller to execute economy of scale crop and livestock production. Respondents were also asked to evaluate subjectively changes of crop and livestock production overtime. Figure 3.2A illustrates perceived changes of crop yield over two years in which 68% of clients answered that crop yields are 'decreased' this year, compared to the preceding year. By contrast, 29% of the clients confirmed that crop production has 'increased'. Similarity, FGD revealed that bad weather condition severely affected crop production in the survey year.

[1] *Timad* is a local measurement of landholding. One *Timad* is approximately equal to 0.25 hectare.

Figure 3.2 Views of ACSI clients on production changes over two periods



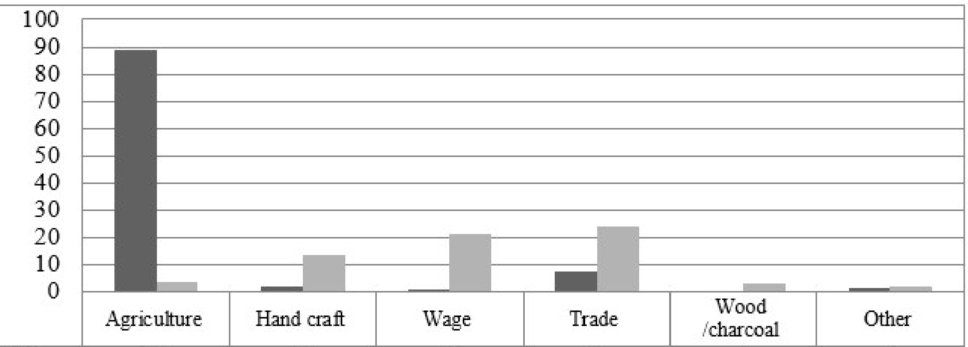


Source: Own survey, 2007

Moreover, figure 3.2B demonstrates subjective evaluation of clients concerning livestock production trends. In line with figure 3.2B, 42% of clients affirmed that livestock production has diminished in the survey year, compared to the foregoing year. Those representing 40% of the clients stated that livestock production has 'increased'. Besides, participants of FGD disclosed that bad weather and animal feed scarcity were the driving forces behind the reduction of livestock production. In-depth interview with ACSI employees underscore that livestock size should have increased since many clients received credit for livestock rearing.

Since rural people are involved in farm and non-farm economic activities, respondents were asked about their primary and secondary economic activities based on the amount of time spent per se. Figure 3.3 demonstrates primary and secondary occupations ranked by clients. Close to 89% of clients confirmed that agriculture is a primary occupation. In other words, they spend more hours on agricultural activities. Quite the reverse, fewer clients have ranked non-farm activities (largely petty trade, wage and handcraft) as a primary occupation. Instead, clients leveled those non-farm activities as secondary occupations. For instance, 24% of clients ranked petty trade a secondary occupation whereas 21% of the clients rated wage as a secondary occupation.

Figure 3.3 Ranking of economic activities based on the amount of time spent (percentage)



	Agriculture	Hand craft	Wage	Trade	Wood /charcoal	Other
First economic activity	89	1.5	0.5	7.5	0	1
Second economic activity	3.5	13.5	21	24	3	2

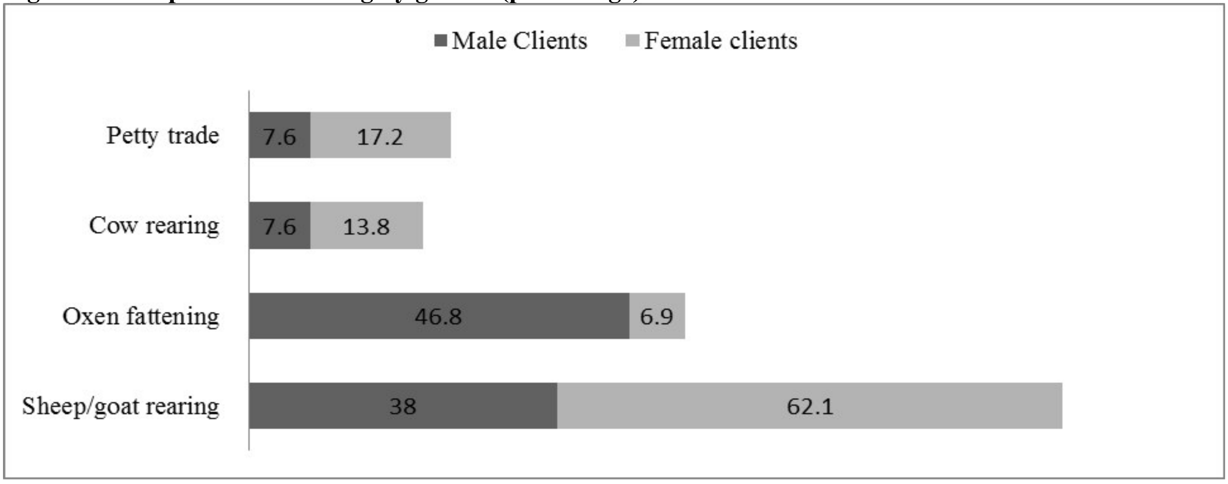
Source: Own survey, 2007

Note: All respondents ranked their primary economic activities but only 67% of the total respondents were able to mention secondary economic activities. This suggests that 33% of the sample clients have no secondary occupation.

Purpose and actual utilization of loans

Often MFI provides group-based lending for productive activities even though clients actually utilize loans for productive and unproductive activities. In-depth interview with ACSI employees verified that ACSI delivers two types of loan products in rural Wereilu District. These are livestock and petty trade loans. Livestock loans include sheep, goat, cow and ox rearing. Petty trade loans include any kind of trade that clients foresee profitable. Figure 3.4 exhibits purposes of loan taking that it differs between female and male clients in the survey year. Nearly 62% of female clients received loans to buy sheep/goats and 38% of male clients borrowed for the similar purpose. In contrast, 7% of female and 47% of male clients took credit for oxen fattening. Besides, 17% of female clients took loans to undertake petty trade while 14% of them borrowed for cow rearing. FGD asserted that male clients prefer loan for oxen fattening because they utilize oxen for plowing land. Females are not enthusiastic to borrow money for oxen fattening since females do not plow by tradition. Nevertheless, female clients coming from male-headed household could receive loans for oxen rearing. Participants of FGD also elaborated that sheep/goat rearing is relatively profitable and requires less animal-feed expenditure. Therefore, both female and male are interested to take loans for sheep/goat rearing. Participants explained that many clients are unwilling to borrow for cow rearing (for instance, cows need longer duration to give calf and sell grown up calf) because the return to investment is not feasible vis-à-vis loan repayment duration.

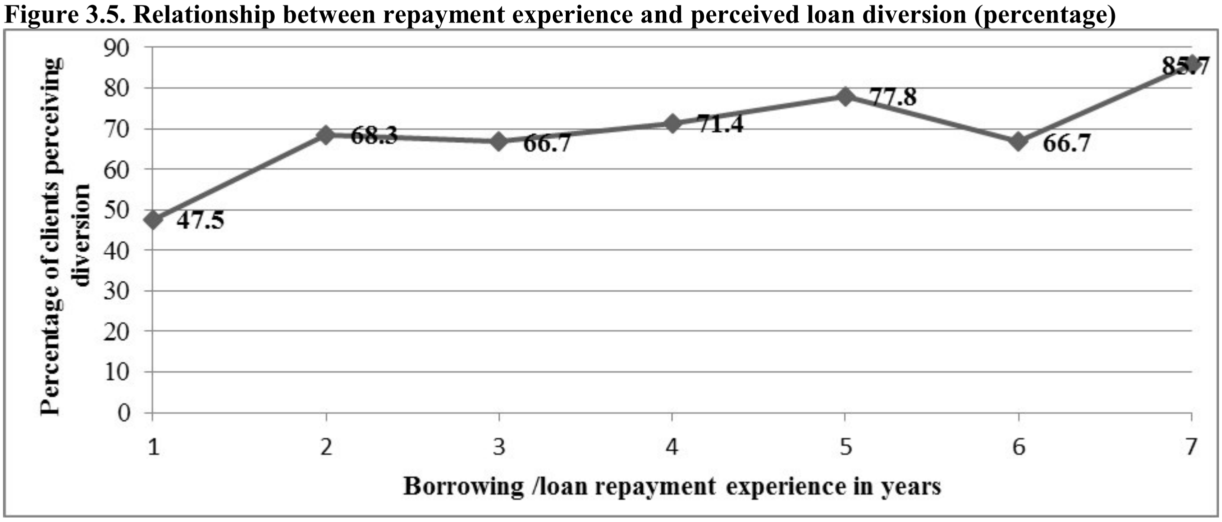
Figure 3.4 Purpose of borrowing by gender (percentage)



Source: Own Survey, 2007

In addition, FGD revealed that there is divergence between the *borrowing purpose* and *actual loan utilization.* According to the FGD, some clients switch loans for pressing needs (FGD participants call it - '*ekil*' or '*yegil tikar*'), instead of using it for pledged purpose. Apart from FGD information, the study also assesses the clients' perception toward loan diversion practices (see figure 3.5). Of those clients who have one-year repayment experience, nearly 48% of them perceived that some clients divert a fraction of the loan private purposes rather than ACSI-funded projects. Next, 68% of clients with two-year repayment experience perceived the existence of diversion at least a portion of the loan. Moreover, 86% of highly experienced clients (that is having seven-year borrowing experience) perceived that there exists loan diversions. To sum up, clients with longer borrowing experience exceedingly recognized the existence of loan diversion practices than those with shorter borrowing experience did.

Figure 3.5. Relationship between repayment experience and perceived loan diversion (percentage)



Source: Own Survey, 2007

Sources of finance for repayment

Not all sources of finance for loan repayment are good. Some repayment sources may lead to resource depletion, trapping clients to the vicious circle of poverty. Therefore, the study asked clients concerning financial sources to repay ACSI loan. In this regard, clients subjectively weighted the relative importance of financial sources to repay ACSI loan. The response values were 1= 'not important', 2 = 'important' and 3= 'very important'.

Table 3.1 Importance of different financial sources in servicing ACSI- loans (average)

Sources of finance	Average
Wage income	1.05
Income from ACSI-funded projects (livestock & petty trade)	2.56
*Informal institutions' loan (relatives, friends, individual money lender, *Iqub,*)	1.25
Sale of crop /grain	1.5
Formal institutions' loans (Extension Package, Safety Net, Cooperatives, World Bank)	1.04
Income from Non ACSI-funded projects (such as trade, handcraft, weaving, etc.)	1.18
Sale of own livestock	1.02
Sale of animal feed	1.03
Sale of charcoal and firewood , etc	1.07
Pension ,salary & remittance	1.05
Others (asset selling, land renting out , animal renting out)	1.04

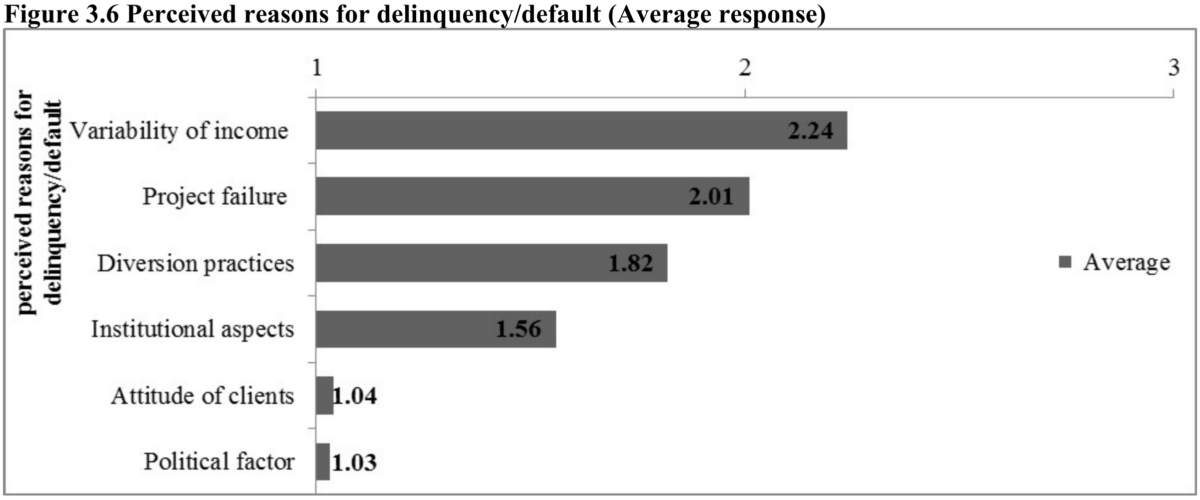
Source: Own survey, 2007 **Igub refers to an indigenous revolving credit and saving association.*

As depicted in table 3.1 above , the single most important source of financing for loan payments is the income generated by ACSI funded-projects , averaging 2.56 (out of 3 points). The sale of crops is the second important financial source to service ACSI loan. Informal loans (namely friends/relatives, *Iqub* and individual moneylenders) are rather the third valuable sources in repaying ACSI loans. Nevertheless, wage income, formal institutions' loans, own livestock sale, non-ACSI funded-project income, animal feed sale, firewood & charcoal sale and 'others' are not essential sources of financial for the repayment of ACSI loan.

Reasons for loan delinquency and default

When clients borrow money, they risks delinquency and even default. Delinquency and default challenges the viability of both clients and lending institutions. Therefore, the study asked the perception of respondents why some clients run into delinquency/default. Clients appraised some items containing perceived reasons for loan default/delinquency. The item values range from 1 to 3 where 1= 'not reason', 2 = 'reason' and 3 = 'very reason'. As described in figure 3.6, clients viewed seasonal income variability as the main reason for delinquency/default, averaged 2.24. Clients also placed failure of ACSI-funded projects second causing default/delinquency (i.e. an average response of 2.01). On average of 1.82, clients rated that loan diversion practice is the third alleged reason for delinquency/default. Lastly, institutional aspect was the fourth important reason for delinquency/default, averaging 1.56. On the other hand, the effect of clients' attitude and political factor on delinquency/default is virtually non-existent. FGD alleged fluctuation of market price for delinquency/ default of clients. FGD argue that higher livestock supply occurs at the ending of loan term, resulting extremely lower livestock price. Clients tend to be delinquent if they delay selling livestock until the market price gets right. Such does not happen on petty trade loan that requires repayment on monthly installment basis. FGD added that those clients behaving loan diversions have the risk of delinquency/ default.

Figure 3.6 Perceived reasons for delinquency/default (Average response)



Source: Own Survey, 2007

Institutional aspects

Credit delivery modality, loan-products design and monitoring mechanisms of lending institutions are decisive for effective loan utilization and repayment performance of clients.

Credit delivery modality

In-depth interview with employees ascertain that credit delivery modality of ACSI is an *individual credit-based solidarity group guarantee* (kind of Grameen Bank Model). It allows unrelated individuals to form self-selected groups to borrow and utilize loans individually. Roughly, eight to twelve groups would set up a village 'center'. Group members guarantee each other's loans and are mutually accountable for repayment if a member does not repay the loans on due. It is compulsory to attend regular meetings, contribute regular savings and invest the loan productively. In principle, groups select creditworthy members who could monitor loan utilization and enforce repayment. Hence, the modality is envisaged to create social pressure/ peer pressure/so those members would work harder, fearing social humiliation and stigma.

In-depth interview shows that credit delivery process follows certain procedures. Initially, screening duty rests on the shoulder of Credit and Saving Committee (composed of Community Leaders and *Kebele* Administrators). The Committee recruits potential clients who are active-poor, healthy and ethical. A potential client should be free of debt and bad habits. Using Rapid Rural Appraisal (RRA) technique, individuals having 'one ox or no ox' are eligible. Moreover, the candidate should possess land. Once the Committee sends the list of eligible borrowers, ACSI allows clients to form groups. The group size ranges from five to seven. Self-formed group members must not be relatives. However, FGD disclosed that there are clients forming membership with relatives even if group members are not motivated to report the infringement of ACSI policy.

Design of loan products

An in-depth interview with ACSI employees portrays that ACSI has two types of loan packages. These products are *regular loans* and *package loans*. *Regular loan* is disbursed to a large number of rural clients in Wereilu District. Further, the regular loan is sub-divided into two: livestock and petty trade. In accordance with ACSI lending policy, credit officers distribute second-round loan to group members as soon as the first-round loan is successfully repaid. As incentive to repayment, *loan size* increases step- by-step to a certain level. A client moving from the first to the second-round loan can expect 100% addition to the first loan size, then addition to the preceding loan of 75% in third cycle, 50% in the fourth cycle, 25% in the 5th cycle and the subsequent cycle. Moreover, the initial loan and loan ceiling differ between livestock and petty trade activities. Currently, the ceiling level for petty trade loan is Birr 5000 whereas the ceiling for livestock loan is 3000 Birr [1]. According to the interview, the *repayment frequency* varies with the type of loan product. Livestock loans are repaid at the end of the loan term, lump sum installment. Petty traders repay monthly installments since it enjoys continuous cash flow patterns. However, the *repayment duration* is identical for both loan product types.

FGD pointed out that the repayment duration is not suitable for livestock loan (particularly cow rearing). They argued that livestock needs at least two years in generating sufficient income. FGD also stressed that regular *compulsory saving* ignores income-generating capacity of clients. Several clients often borrow from informal institutions (relatives , friends and intra- group members loan) and sell crops for the sake of compulsory saving . On the other hand, FGD confirms that *interest amount* (additional to the principal value) troubles those clients taking loans for oxen rearing. Instead of fattening oxen, clients use oxen for farm activities (plowing land and threshing crops). For this reason, revenue from reselling oxen is not likely to cover both the principal and interest amount.

Monitoring mechanisms

According to the in-depth interview, employees are responsible to perform loan utilization monitoring, repayment monitoring and training activities. They monitor *actual loan utilization* through scheduled and unscheduled supervisions. At the outset, clients must display the purchased livestock one month after the loan is disbursed. Employees register color, number and price of the livestock during scheduled supervision. Further, they keep recording death, loss and other incidences of the livestock; and they make unscheduled supervisions at least twice per year. Quite the reverse, employees have no monitoring mechanisms for petty trade loans. Employees also monitor *loan repayment process*. ACSI workers often remind clients about the repayment frequency, advise them to search markets and prepare the repayment amount. furthermore, they provide *training* services pertaining to group formation, credit and saving services, loan utilization, repayment process and the like during the 'center meetings'. At the time of the regular meetings, employees distribute loans, follow up clients' attendance, collect compulsory savings and charge absenteeism penalty. FGD and in-depth interview revealed the following challenges of the monitoring process.

- The regular attendance at 'center meeting' is gradually weakened since many clients are used to be absent in the pretext of funeral, illness and other reasons. In addition, clients travel a long distance to attend the center meeting.
- Employees always convey routine messages during the center meetings.

4. Discussion and conclusion

Discussion

In the preceding section, the study presents descriptive results of clients' socio-economic characteristics, loan utilization practice, financial sources to repay loan and perceived loan default/delinquency reasons as well as the

[1] Birr refers to the Ethiopian currency; roughly the exchange rate of 1 dollar =10 Birr in 2007.

lending institution's loan-product design and monitoring process. In this section, the study interprets findings and implications.

The *socio-demographic characteristics* of clients indicate that Amhara Saving and Credit Institution (ACSI) has quite large number of female clients. This probably occurs because of the institution's lending policy. Indeed, the policy objective of ACSI aims at alleviating poverty and increasing resource position of the productive poor, particularly women (ACSI, 2004). Consistent with this finding, Johnson & Rogaly (1997) explained that one of the principal objectives of most MFIs is to improve economic status, decision-making power, and community participation of women. Having higher proportion of women clients is also beneficial for good loan utilization and repayment performance. Ledgerwood (1999) and La Torre & Vento (2006) stated that women clients are generally capable of managing microcredit.

Interestingly, the age of a typical client falls within 'adult working age'. Potentially productive working age can utilize loans for profitable venture rather than consumption. This age group tends to have better entrepreneurial skills. On the other hand, many clients are uneducated. Unfortunately, illiteracy is highest among female clients. Microcredit requires functional literacy for sound business decisions-including production, financial and marketing. Therefore, lower educational level is a challenge for clients' productivity and enterprise growth, all else constant. Similarly, it could restrain effective loan management, such as utilization and repayment performance. Yaron, Benjamin and Piprek (1997) illustrated that primary education has a long-term benefit for the rural poor. In addition, Ledgerwood (1999; 89) stated that education for "micro entrepreneurs" significantly improves enterprise activities. Further, the survey demonstrates that clients belong to either Ethiopian Orthodox or Sunni Islamic religion. Interestingly, the religious diversity does not constrain loan group formation and solidarity. Instead, there appears strong cultural bondage, respect and even blood-ties between followers of both religions. There is no religious barrier for women's participation in microcredit market. However, Ledgerwood (1999) noted that women are restricted from having access to MFI credit in some Islamic culture.

Landholding, livestock and crop-yield are valuable possessions measuring *economic status* of the rural poor. However, ACSI clients hold very small and fragmented land unsuitable for economies of scale crop and livestock production. Besides, the self-rated subjective wealth has generally decreased in the survey year than before. There are two possible reasons. First, clients comforted unfavorable weather conditions and animal-feed shortage in the survey year. Second, some clients could underreport their wealth because of 'aid' mind-set developed before or comparing self with 'wealth reference group' in their village. Dejene (1990) explained that land fragmentation, periodic drought and low agricultural productivity are amongst chronic rural problems in Ethiopia. Concerning the economic activities of clients, agriculture is the single most important economic activity. Clients are engaged in narrow non-farm activities, namely petty trade, handcraft and wage. Although the non-farm sector poorly contributes to the clients' economy, Brune (1990) explained that the sector has potentially important role to diversify rural income and enhance the agricultural sector of Ethiopia. In fact, the non-farm sector has strategic functions, such as employment creation, agriculture-industry linkage, industrialization and particularly poverty reduction.

With respect to the *purpose of loan taking*, the survey finds that ACSI generally delivers 'directed loan'. This type of loan is designed to the active-poor for productive investment whose repayment coming out of revenue earned from the investment (Johnson & Rogaly, 1997). Meanwhile, clients receive directed loans for narrower range of productive purposes: livestock and petty trade. Livestock loan is the most common and dominant form in Wereilu District. This shows that ACSI loan-products are narrower in width and breadth. Nevertheless, Mellor (1966) demonstrated that rural areas where traditional agriculture dominates people have multitude credit demands arising from seasonal patterns of consumption and production, working capital, long-term capital investment and emergency events. Surprisingly, the purpose of borrowing differs between female and male clients. It appears that traditionally created gender role affects the choice of loan types. In rural Wereilu, men are largely responsible to cultivate land whereas women are in charge of milking cows, selling milk by-products, and herding sheep/goats. This could be the reason why several female clients borrow primarily for sheep/goat rearing, followed by petty trade and cow rearing businesses. On the other hand, many male clients take loans for oxen fattening [1]. Ledgerwood (1999) also elaborated that women owned-businesses are characterized by risk reduction strategies, concentration in petty trade and seasonal economic activities.

Even if the lending policy of ACSI prohibits loan diversions, the survey demonstrates that clients practice *loan diversions,* indicating deviation between *purposes of loan taking vis-a-vis actual loan utilization.* Interestingly, a large portion of clients with longer borrowing experience perceived that loan diversion practices are common. This finding also corroborates other empirical evidences in Ethiopia. Getaneh (2002) found that experienced borrowers in ACSI had higher probability of loan diversion. He added that clients divert loans because of ACSI-funded project failure. Johnson & Rogaly (1997) explained that MFI clients might divert loans

[1] Oxen are the most valuable asset for plowing (serving as tractors) in rural Wereilu District.

to meet a range of household needs owning to closer linkage between productive and non-productive activities. Clients could divert loans for consumption, health, education, or other emergency needs that indirectly improve productivity or prevent sale of valuable assets. Ledgerwood (1999) stated that directed loans are highly vulnerable to diversions and risk of default.

In the context of rural credit market, clients utilize different *financial sources for loan repayment* (Mellor, 1966; Wiig, 1997). This study shows that from ACSI-funded project revenue is the single most important source to finance ACSI loan. Even though it is necessary the project-revenue should finance its debt, frequent 'livestock buying-selling' has challenged asset building/wealth accumulation of clients. The second important source to finance ACSI loan is crop sale, followed by informal loans. However, crop sale and informal loans imply that some clients have encountered either loan diversion for un-productive activities, unprofitability of ACSI-funded projects, or inappropriate credit delivery systems of ACSI. This finding notes that crop sale and informal loans are potentially risky financial sources. Empirical evidences also support such interpretation, hitherto. Mellor (1966) demonstrated that sale of valuable assets (for example, crop sale) to repay loan exacerbates asset depletion. Wiig (1997) argued that use of financial sources other than the MFI funded-project revenue for repayment expose clients to poverty. Further, Wiig (1997) and Ledgerwood (1999) argued that taking informal loans to service another loans have detrimental effect, leading clients to unmanageable debt burden and risk of default. The situation of using one source of loans to service another loans is called cross-financing (Wiig, 1997) or ponzi finance (Borchgrevink et al., 2005). In contrast, some authors argue that informal loans are not always negative. Urdry (1990) and Hoff & Stiglitz (1993) argue that informal institutions have more flexible and appropriate loan products suiting the rural poor needs.

Generally, the survey demonstrates that clients' financial sources to repay ACSI loan are not diversified. Besides, the alternative sources (namely crop sale and informal loans) to finance ACSI loan are risky sources, which could aggravate assets depletion and debt burden. More interestingly, formal institutions' loans, wage income, non-farm sector income and other saleable assets were not important sources for the repayment of ACSI loan.

This paper has also portrayed the perceived *reasons for loan delinquency/default*. Ledgerwood (1999) clarifies the concepts of delinquency and default. Delinquency reflects loans that are not paid on time while default refers to loans that must actually be written off. The paper has grouped the perceived reasons for delinquency/default into six categories despite apparently overlapping nature of the classification. These include funded-project failure, client attitudes, seasonal income variability, diversion practice, lending institution's capacity and political factors. In view of that, seasonal income variability becomes the main perceived reason for clients' delinquency/default. Sanderatne (1983) asserted that rural borrowers are highly vulnerable to seasonal income shock due to price fluctuation of agricultural products. In fact, ACSI funded-projects are predominantly agricultural-oriented which are vulnerable to seasonal market price fluctuation. There are also factors (including theft, fire and other hazards) that results in seasonal income variability (Sanderatne, 1983). This finding corroborates empirical evidence from informal markets in Ethiopia. For example, Bezabih et al. (2005) found that lower market price, lower market demand and crop failure were the main reasons for credit default.

Besides, the study finds that ACSI-funded project failure is the second most important perceived reason for default/delinquency. Project failure is inherently related to *production defects* (for example, land size, poor inventory, traditional system of livestock rearing, etc). Sanderatne (1983) explained that investment failure owning to the defects of production factors is amongst the main causes of agricultural credit default. Further, this survey finds that loan diversion practice is the third important perceived reasons for default /delinquency. According to Sanderatne (1983), loan diversions can occur in two ways. First, clients may shift loans to non-productive activities, such as consumption expenditure (wedding ceremony, funeral ceremony, medication, clothing, food, etc.), repayment for informal lenders and so forth. Second, clients can divert loans for productive investments; but, diversion to riskier productive projects may lead to default/delinquency. The study demonstrates that institutional aspects are the fourth important factors causing delinquency/default (please see figure 3.6). Institutional aspects include loan-product design, credit delivery modality and monitoring mechanisms of MFI. Lastly, the study finds that clients' attitude and political factors have negligible effect on delinquency/ default in Wereilu District. This study implies that credit repayment culture/attitude is improved. Sanderatne (1983) stated that attitude-related default is caused by those who have the ability but unwilling to repay loan, viewing loans as charity. Politics is not a reason for delinquency as well. This phenomenon shows that local political elites do not noticeably exchange political support with loans.

With reference to *institutional aspect of ACSI*, credit delivery modality of ACSI is an individual credit-based solidarity group guarantee. The group lending modality allows relatively well-off clients form self-selected group by marginalizing the poorer section. During group formation, individuals usually stress on debt paying capacity of members in due course, instead of the capacity of utilizing loan for the pledged activity. Since like-minded members of a group could not monitor loan utilization, weak peer monitoring system permits members freely practice loan diversions. Second, the marginalized individuals who are screened out in one village form groups with similar individuals in another village. Peer monitoring of loan utilization of such groups is also weak owning to non-proximity and information asymmetry. Third, group leaders, so-called role models, are not active to coordinate and motivate members. Overall, peer monitoring/social collateral lacks efficacy and effectiveness to control loan utilization for the intended purposes. Similarly, research by Borchgrevink et al. (2005) on DECSI clients (in Ethiopia) disclosed that group-lending method allowed individuals with sufficient asset position to have access to loans by excluding the poorer section. Apart from this, client-screening policy of ACSI is malfunctioning. First, it does not guarantee eligibility right for the landless citizens. Second, the Rapid Rural Appraisal (RRA) technique that uses 'one ox' as poverty threshold disregards the local context. For example, many richer peasants retain utmost 'one ox' because of smaller land size for cultivation and grazing.

The design of loan-products (including loan size, loan term, repayment frequency, cash flow pattern, compulsory saving/collateral and interest rate) is homogeneous to all ACSI clients not only Wereilu District but also other districts of Amhara Regional Sate (ACSI, 2004). Thus, the loan scheme is supply-driven. This also indicates the loan design does not segment its target market and lacks flexibility. Ledgerwood (1999) elaborated that loan products need to be designed according to the demands of the target market. ACSI applies progressive lending in which loan size increase step-by-step to a certain level. Interestingly, repayment frequency follows the cash flow patterns of the loan-products. For example, since the cash flow pattern of petty trade is continuous, repayment frequency is arranged on monthly basis. Clients of livestock loan pays in lump sum at the end of the loan term because their cash flow pattern is seasonal. In contrast, both petty trade and livestock loans have identical repayment duration. ACSI is criticized for having short repayment duration for livestock loan. Arguably, the regular compulsory saving (i.e. collateral substitute) has seriously challenged clients of livestock loans while higher interest rate imposed difficulty on those engaged in oxen fattening.

Monitoring mechanism of ACSI employees include three activities: loan utilization, loan repayment, and training. Loan utilization monitoring involves registration of livestock, field visit and closer supervision (scheduled and unscheduled supervision). Loan utilization monitoring also depends on reliable, relevant, accurate and timely information provided by clients. Therefore, loan utilization monitoring incurs more transaction costs and information asymmetry. On the other hand, loan repayment monitoring involves information dissemination regarding market price, repayment frequency and loan term by employees themselves. Loan repayment monitoring has less transaction cost. Employees provide training primarily on financial intermediation. Employees do not provide complementary training to the financial services, such as entrepreneurship skills and education. It appears that ACSI pursues minimalist approach rather than integrationist approach. Integrationist approach combines both financial and social intermediation. Ledgerwood (1999) stated that social intermediation helps to build social capital between clients and MFI. It is also effective to enhance peer monitoring. Social intermediation involves basic management skills, education, health, nutrition, and literacy training. In marginalized society, successful financial intermediation of MFI is always accompanied by social intermediation successful financial intermediation (*Ibid*, 1999). Additionally, clients bear comparably high transaction costs. The study finds that are not comfortable with the regular 'center meeting' and the penalty fee for late arrival. Moreover, it also clients do not tolerate longer distance travelling to attend the regular meeting. This challenges specially women clients who have multiple roles in the community.

Conclusion

The objective of the paper is to assess loan utilization and repayment practices of rural microfinance clients in Wereilu District-Amhara Regional Sate. The study evaluates MFIs credit market from the client perspective rather than intermediary perspective. As a result, the study provides descriptive analysis on socio-economic characteristics, loan utilization behavior, financial sources for loan repayment, and perceived delinquency /default reasons of clients as well as the lending institution's capacity.

Rural clients of ACSI are predominantly composed of adult working age and uneducated clients. The economy of clients depends on agriculture (mainly crop and livestock production) with meager non-farm activities. They also hold fragmented land unsuitable for economies of scale production. Crop and livestock productions are vulnerable to seasonal shock due to mainly unfavorable weather conditions and animal-feed shortage. In the meantime, clients receive 'directed loans'. The directed loans are narrow in width and breath that coexists with unmeet multitude credit demands. As a result, clients are practicing loan diversions. What is more, clients depend on undiversified financial sources for the repayment of MFI loan. The fundamental sources of finance to service ACSI loan include ACSI-funded project revenue, crop sales and informal loans. The latter two financial sources are riskier means that tend to constrain livelihood improvements of the rural poor. The perceived reason for delinquency /default of ACSI clients includes seasonal income variability, ACSI funded-project failure, loan diversion practices and the lending institution's capacity. Conversely, client attitude and political factors are not important reasons for delinquency/default.

Lending policy of ACSI also impends up on loan utilization and repayment performance of rural clients. First, the group lending modality (i.e. individual credit-based solidarity group guarantee) allows relatively affluent clients to have accesses to credit, marginalizing the poorest of the poor. The pressure group is weak to monitor loan utilization; but it is effective to ensure loan repayment. Second, the loan-product design tends to be homogeneous which lacks target market segmentation and flexibility. Thus, the loan scheme is supply-driven. Further, employees of ACSI administer three aspects the credit services: loan utilization, loan repayment, and training services. Loan utilization monitoring incurs higher institutional transaction cost and information asymmetry than loan repayment monitoring does. Training activities stresses on financial intermediation. Thus, the lending institution prioritizes financial intermediation (minimalist) rather than both financial intermediation and social intermediation (integrationist). In contrast, clients bear transaction costs in terms of absenteeism penalty fee, frequent long-distance travel, and regular meeting

Therefore, the lending institution and policy makers should consider demand-driven and diversified loan packages, rural microbanking services, intra-group microinsurance, reforming beneficiary screening policy and integrating financial intermediation with social intermediation.

However, readers should notice *limitations of this research.* The research uses cross sectional survey design because of the scarcity of longitudinal data even though longitudinal data more suitable to analyze loan utilization and repayment practices of clients. It also employed descriptive analysis that eschews hypothesis testing and statistical inference. On top of that, it is stuck to some factors and variables drawn from microfinance literature including socio-economic characteristics, loan utilization, sources of finance for repayment, reasons for default/delinquency and institutional capacity. Lastly, the research does cover only clients of Amhara Saving and Credit Institution in Wereilu District. Readers should be, therefore, precautious not to generalize the findings to other clients and MFIs of Ethiopia.

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Acronyms and Abbreviations

ACSI	Amhara Credit and Saving Institution
ADLI	Agricultural Development Led Industrialization
DA	Development Agent
DECSI	Dedebit Credit and Saving Institution
FDRE	Federal Democratic Republic of Ethiopia
FGD	Focus Group Discussion
GB	Grameen Bank
GDP	Gross Domestic Product
HDI	Human Development Index
MFI	Micro Finance Institution
NGO	Non-Government Organization
RRA	Rural Rapid Appraisal
UNDP	United Nations Development Programme
WB	World Bank

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