Handling Default Risks in Microfinance: The Case of Bangladesh

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HANDLING DEFAULT RISKS IN MICROFINANCE: THE CASE OF BANGLADESH

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Abstract

Despite the current enthusiasms in applying the concept of microfinance as a poverty alleviation tool in many countries, the risk management aspects of microfinancing should not be overlooked. This paper highlights several incidences of default risks in microfinance and subsequently, provides a comprehensive exploratory study on the various ways to handle the default risks in microfinance. While there are social and religious objectives embedded in extending microfinancing, fact is that the financiers are business entities having the objectives of maximizing returns and minimizing losses. In this regard, this paper contributes towards a more effective recovery process, so that more people can benefit from the microfinancing facilities. Several suggestions are highlighted to maximize the benefits of microfinance to both the creditors and borrowers with the objective of realizing a win-win situation for both parties.

Keywords: Microfinance, default risks, recovery process, Bangladesh

1. INTRODUCTION

Accessibility to financing is one of the critical factors that ensures the viability and sustainability of a business venture. To the poor, accessibility to financing is often the biggest stumbling block towards realizing a business opportunity mainly due to lack of physical collateral. Realizing this limitation, microfinance is being introduced with the objective of providing the poor the accessibility to finance so that their standard of living can be improved. Microfinance can be seen as an effort to improve poor people's access to loans and saving services. A survey by Paxton (1996) showed that there were about 200 microfinance institutions (MFI) managing around 13 million loans worth US$7 billion and 45 million savings accounts worth US$19 billion worldwide in 1995. At the end of 2006, the number of MFIs has increased to 704, serving about 52 million borrowers with US$23.3 billion in outstanding loans and 56 million savers with total deposits amounting to US$15.4 billion. Of these microfinance recipients, 70 percent were in Asia, 20 percent in Latin America and the balance in the rest of the world.

Based on the current market trend, microfinance can be categorized as a rapidly growing market as the support for it comes not only from the commercial aspect but also the social aspect.

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A movement seeks to establish credit as a human right and to raise $20 billion to provide microfinance to 100 million of the world's poorest families by 2005 (Daley-Harris, 2002; Microcredit Summit, 1996). Today, microfinance has a global outreach and become the fastest growing and most widely recognized anti-poverty tool. The concept of microfinance has been widely accepted and applied as an element of national development policy for poverty reduction strategy in many countries throughout the world.

Despite its remarkable achievements, there remained several weaknesses in microfinance that need to be improved to ensure its continuous development and successful implementation. A critical aspect of microfinance that needs to be focused on is the risks management aspect. Micro-finance is entrapped by various types of risks, such as default risk (Goetz and Gupta, 1995), disaster risks (Kumar and Newport, 2005), currency risk (Lewis, 2005), interest rate risk (Hughes and Awimbo, 2000; Rahman, 2005) and commercialization risk (MicroBanking Bulletin, 2003).

While the success story of microfinance has commonly been attributed to the Grameen (Village) Bank of Bangladesh which was founded in 1976, several complications can be traced to the US experience in the late 1970s. The precursors of microfinance rural credit and small farmer credit had a history of dramatic policy failure. The experience in Ohio has shown that attempts to provide the poor people, in particular the small farmers with small loans had been a disastrous policy (Adams et al., 1984). The program failed to get credit to poor people, did little to improve agricultural yields and had high rates of default such that viable rural finance institutions could not be established. Poor people were viewed as simply, not being bankable. The high unit costs of transactions, inability of poor people to repay loans and political manipulation of such initiatives meant that development policy should withdraw from this domain and leave all banking to the private, for-profit sector.

This paper focuses on the issue of managing default risk in the specific context of microfinance. Default risk is chosen instead of other type of risks because default risk has severe negative repercussions on the success of microfinance. A series of defaults could lead to liquidity problem in the MFIs and would consequently limit the ability of the MFIs to extend loan to other recipients. As would be revealed later, due to the serious consequences of defaulted loans, the MFIs might resort to various ways to reduce the possibility of default among the borrowers. To be meaningful, this paper quotes several real cases of default incidences and based on these incidences, it provides recommendations to handle the default risks. The objective of this paper is to provide a comprehensive exploratory study on the various ways to handle default risks in microfinance. Ultimately, as the incidences of customers defaulting on the loans being reduced, this leads to a more effective credit recovery process, thus more people can benefit from the microfinance facility.

The rest of this paper is organized as follows: the next section discusses the issue of default risks in microfinance. Having understood the magnitude of the default risk problem in microfinance, Section 3 presents several real incidences of default in microfinance in Bangladesh. Section 4 identifies the causes of defaults in microfinancing and Section 5 provides several recommendations to mitigate default risk in microfinance. Lastly, Section 6 concludes.

2. IS DEFAULT RISK AN ISSUE IN MICROFINANCE?

Default risk refers to a situation where the lenders are unable to recover the loans that have been extended or the borrowers fail to fulfill their financial obligations at the stipulated time due to various reasons. In general, default risk is claimed to be a non-issue in microfinance. Taking Grameen Bank as an example, since its inception, the bank has distributed around Tk347.75 billion (or an equivalent of US$6.55 billion) in loans. Of this amount, Tk313.11 billion (or US$5.87 billion) has been repaid[3]. The bank claims a loan recovery rate of 98.4 percent in 2003, an improvement compared to the 95 percent recovery rate claimed in 1998. In short, micro-lending is known to have very low default rate, such as in the case of Grameen Bank which has a default rate of as low as 2 percent[4].

However, many critics doubt this recovery rate, particularly on the definition that Grameen Bank uses to categorize loan as default as well as the method of recovering the loans being extended. Micro lenders have been reluctant to highlight the weaknesses of Grameen Bank mainly due to its well-known reputation as a symbol of microfinance. However, in the recent years, the repayment difficulties faced by Grameen Bank are even acknowledged by the founder himself, Mr. Yunus. Several factors have been attributed to the repayment difficulties such as political upheavals, the 1998 flood and management errors. Information lag due to inefficiency is also quoted as another reason, where the recovery rate of 95 percent was only true until 1996.

In 2001, about half the loan portfolio in two northern districts of Bangladesh that have been used to highlight Grameen's success is overdue by at least a year. For Grameen bank as a whole, 19 percent of loans are one year overdue (Pearl and Philips, 2001). Grameen itself defines a loan as delinquent if it still isn't paid off two years after its due date. Under this definition, about 10 percent of all the bank's loans are overdue. As a comparison, in 1997, 4.6 percent of Grameen's loans were more than two years overdue. The worst case is in the Tangail region with 32.1 percent of the loans are two-years overdue. There are also other issues such as stiff competition among the MFIs. In Tangail for example, villagers recalled that they were being offered by seven competing microlenders -- a typical repayment plan for a 1,000-taka ($17) loan is 25 taka a week for 46 weeks. At an annualized rate, that works out to 30 percent in interest. Also, it is estimated that around 23 to 40 percent of families have multiple borrowings from several MFIs in Tangail. Also, there is the issue of repeat borrowers who have become dependent on loans for household expenditures rather than capital investments. Studies of micro credit programs have found that women often act merely as collection agents for their husbands and sons, such that the men spend the money themselves, while women are saddled with the credit risk[5].

More importantly, field investigations revealed that the high degree of loan recovery in microfinance is partly contributed by some element of "forced-recovery" imposed on the borrowers, either directly or indirectly. Informal interviews with the villagers and direct observations in the villages seem to indicate that there are actually frequent incidences of default in microfinance. In some cases where the borrowers are not able to pay back their loans, they are

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3 "Grameen Bank Historical Data Series 2003" (in English), Grameen Communications, (2004-07-21), Retrieved on 2008-01-17.

4 See http: // www. Grameen-info.org/

5 Goetz, A.M. and R. Sen Gupta. "Who takes the Credit? Gender, power and control over loan use in rural credit programmers in Bangladesh." *World Development* Vol. 24, January 1995.

pressured to repay with whatever means that they have. In several circumstances, the borrowers faced losses where their business or agriculture projects do not bear fruit but they still have to repay according to the agreement that they have had with the MFIs. As a result, these borrowers were forced to sell off their lands or whatever property that they have, making them poorer than they were before and sometimes even making them homeless. Obviously, in this case, the MFIs are successful in recovering the loan that they have extended but the true objective of microfinance of alleviating poverty and improving the living standard of the poor are clearly being ignored.

3. REAL INCIDENCES OF DEFAULTS IN MICROFINANCE

Based on field visits, in this section, we present several real incidences of default cases. Subsequently, the causes of default in microfinance can be identified and from there on, several recommendations can be suggested to minimize default risks in microfinance.

From the following incidences of default, it can be concluded that the MFIs are only concern about extending financing without much effort being done to provide any form of post-disbursement supervision. Post-disbursement supervision is highly relevant in ensuring the success of microfinance project due to the fact that around 80 percent of the recipients of microfinance are illiterate women. Furthermore, around 82 percent of these women had no business experience before joining the microfinance program, while the rest 18 percent had some basic business experiences. The illiteracy of the recipients is rather serious to the extent that some do not even know how to count the amount of money that they received from the MFIs. Commonly, the MFIs provide loan without any technical assistance except for some briefing of around five to ten minutes to the recipients. It should be emphasized that the technical assistance is just as important and should complement the financial assistance in ensuring the success of the business project.

Case 1: Lack of post-disbursement supervision leading to moral hazard

In many instances, once the fund is being released to the recipient, there is no close supervision of how the fund is being utilize. This results in the tendency of moral hazard on the part of the recipients. For example, in a particular case, the recipient is supposed to expand her chicken-rearing farm has instead given the money to her husband on the pre-text of undertaking a more profitable business venture. However, the business venture did not turn in to be profitable, and as a result, the recipient failed to pay the installment of the microfinance loan. After a year, the original amount of loan became almost doubled and the recipient had to pay the debt by selling her house which made the family homeless. This case showed the importance of post-disbursement supervision to avoid the incentive of using the microfinance loan for other reasons than what has been agreed upon. More alarmingly, this case showed that the recipient took whatever it takes to repay the MFI, resulting in a further deterioration in the standard of living of the recipient.

Case 2: Lack of training on basic business skills and knowledge

Several incidences of default happened due to lack of basic skills such as book-keeping or recording of sale transactions. As mentioned, based on a survey on the recipients of microfinance loan from an MFI in Bangladesh, around 82 percent of respondents had no business experience before joining the microfinance program and only 18 percent had some business experiences. The lack of experience resulted in the recipients unable to manage their business projects effectively, leading to a business failure. In a specific case, a recipient had to close down a tea stall that had been set up using a microfinance facility due to lack of basic business skills and knowledge. Due to illiteracy, the recipient had difficulties to do calculations and keep track of the everyday sales. In the absence of systematic recording of profit or loss in the business, it was difficult for the recipient to estimate expenses that are made allowable by the available profits. As a result, a few months later the recipient had to close the stall and sold it off because of the failure to pay the weekly installments. This is a clear case of default case resulting from the lack of basic business skills and knowledge.

Case 3: Lack of health awareness resulting in the need to spend on medical expenses

As a result of poverty and illiteracy, there is a general lack of awareness on the importance of sanitation and cleanness as well as the importance of healthy food intakes and disease prevention. Family member's illness is one of the reasons leading to recipients to channel the funds provided by the MFIs to pay for medical treatment, resulting in default in payments. In a specific case, a goat-rearing project funded by an MFI turned out to be successful at the initial stage that it provides the recipient with some profit and the ability to repay. However, a family member's illness led the recipient to sell-off the goats in efforts to pay for the medical bills. The recipient later defaulted on the payment.

Case 4: Burdensome immediate repayment schedule

Most microfinance contracts require repayments to start immediately after the loan is disbursed. Since it is common to have weekly payment schedule, most payments normally start the following week after the loan has been disbursed. This payment arrangement proved to be a challenging situation for new and non-experienced recipients since most projects undertaken by microfinance recipients need some incubation period. In a specific case, a woman failed to pay the weekly installments which started directly after the loan was being disbursed simply because her chicken-rearing activity had yet to turn in some profit.

Case 5: Lack of motivation to improve standard of living

It is often overlooked that the mindset of the poor and illiterate are very much different from those who are educated. The poor people have no incentive to give the best to ensure the success of a business project since their major concern is on meeting the daily consumption requirements or just to fulfill the basic needs. In a particular case, a recipient with five children were more concerned to make end meets by setting up a road-side stall and were not concerned about further improving their standard of living. Due to lack of motivation, the recipient had no effort to really give out the best that she could even though she was provided with the financial assistance. This would increase the likelihood of default of the loan being extended.

Case 6: Multiple borrowings from different MFIs

There are also incidences that borrowers took up loans from more than one source. While there is a clear rule that disallowed this from happening unless the first loan is fully paid-off, various ways were being done to go around the rule. In a specific case, a person took loan from an MFI using his name and took a second loan from another MFI using a relative's name. Even though the loans from the two different MFIs were being used for a poultry project, the project did not turn in a high profit as expected. As a result, the recipient faced difficulties to pay for the two installments simultaneously. The recipient then started to pay for only one installment at a time, but was pressured by the other MFI to pay for the installment. Due to the inability to pay, the recipient later had to sell the poultry farm to pay back the loan even though it was profitable.

4. CAUSES OF DEFAULTS IN MICROFINANCE

Based on the real incidences of default mentioned above, in general, the causes of default can be divided into two categories: (i) weaknesses from the **<u>lender side</u>**, particularly in the funds administration by the MFIs; and (ii) moral hazard problem on the **<u>borrower side</u>**.

(a) Lender side -Weaknesses in funds administration: these are weaknesses relating to funds administration by the MFIs that provide the opportunities for the recipients to utilize the loans for other reasons than the original intentions. This increases the possibility of default by the recipients.

i. Absence of post-disbursement monitoring system: in the absence of a close supervision on how funds are being disbursed, recipients tend to utilize the funds for other reasons than the original purpose that the funds were released for.
ii. Lack of technical assistance given to the microfinance recipients: as mentioned, 82 percent of the recipients had no business experience before joining the microfinance program, while the rest had some basic business experience. As a result, the recipients cannot handle their business effectively without basic technical assistance being provided by the MFIs.
iii. Inexperienced field workers: the field workers who are working for the MFIs are lowly educated and lack of experience. Most of them are SSC (equal to O' level) or HSC (equal to A' level) holders and are very young. As a result, they fail to deliver effectively the objectives of the MFIs to the recipients, what more to give motivations to the recipients.
iv. Burdensome immediate weekly payment system: the fixed repayment system is difficult to be met by many recipients, depending on the nature of their business projects. Also, very frequent collection schedule increases the transaction costs to collect the installments for the MFIs.
v. Lack of common accessible database of the microfinance recipients: since there is no systematic database that keeps the record of the microfinance recipients, this provides the opportunity for the recipients to apply for more than one loan from various MFIs. When the recipients are over-stretched in their financial commitments, they are more likely to default on the installment payment.

(b) Borrower side - moral hazard problem: resulting from the lack of technical assistance and post-disbursement supervision, followings are the consequences which result in greater possibility of default by the loan recipients:

i. Hiding business: majority of the recipients are women and in a male-dominant society such as Bangladesh, women are normally obedient to whatever the requests of the husbands. In many cases, once the wife has secured a loan to run a particular business, the husband persuades the wife to undertake more risky business that more likely to provide higher return. Thus, lack of proper monitoring system by the MFI could lead to recipients to undertake more risky business, thereby increasing the possibility of default by the borrower.

ii. Family member's illness: rather than utilizing the loans through the channel that has been agreed upon, the recipients spent it for more urgent and pressing reason such as for medication of the family member. There are also cases where the focus of attention has shifted to taking care of the sick ones, resulting in the business project to be abandoned. Other than illness, funds are also sometimes being spent for other expenses such as marriage and festivities.

iii. Lack of motivations: the mindset of the poor which is more concern about meeting the basic needs does not provide them with the motivations to give out the best in conducting the business project.

iv. Over-stretched financial commitments due to multiple borrowings from MFIs: amid the increased competition among the MFIs and the absence of a common database to keep track of the microfinance recipients, many recipients borrow from more than one MFIs, resulting in the difficulty to meet the multiple payment installments.

5. RECOMMENDATIONS

5.1 To enhance post-disbursement monitoring system

In efforts to reduce the moral hazard problem after the funds are disbursed, there is an urgent need for the MFI to closely monitor how the funds are being spent by the recipients. Post-disbursement monitoring system would include close supervision on the status or progress of the business undertaken and some technical assistance in achieving a viable business project. This includes advice to be given during the initial stage, ensuring consistent progress evaluation, marketing and ensuring the continuity of the business.

5.2 Direct purchasing of equipment and limit the amount of cash disbursement

The structure of financing determines the extent to which the recipient can maneuver with the funds being released. Since in general, around 50 to 60 percent of the loans are needed to buy machinery or equipment related to the business project, the MFI can appoint an agent to purchase the machinery right away, without having to release that portion of the funds to the recipients. The lesser the amount of cash given to the recipient, the smaller the chances of moral hazard occurring. In the case of chicken farm, the MFI might appoint a supplier for equipment and the chicken, and some cash to meet the daily expenses to run the farm. Deciding on the appropriate proportion of cash to be disbursed can substantially reduce the moral hazard problem and ultimately reduce the default risk in microfinance.

5.3 Appointment of central purchaser of business output and direct payment to MFIs from central purchaser

For projects that are undertaken on a relatively large scale basis such as on the "one village one industry basis", the MFIs can arrange that the output of the industry to be sold to only the appointed purchaser. The importance of selling the business output to the appointed purchaser is so that there can be an arrangement that a certain portion of the sale can be used to repay the microfinance loan and the balance to be returned to the seller/recipient as profit. By this way, the repayment is ensured and the risk of default can be reduced substantially.

5.4 Strong training system for recipients and field workers of MFIs

Basic business skill and knowledge are very much needed to ensure a viable business venture in a microfinance program. As such, the financial support provided by the MFIs must also be complemented with the technical support to the recipient. Indirectly, this ensures close supervision of the project at every stage of the business venture since it requires an active participation of the MFIs starting from its planning period until the plan for expansion. For instance, the technical assistance would require pre-disbursement support (in terms of project assessment or viability and providing the recipients with the basic knowledge in the particular project of interest); initial stage of fund disbursement (purchasing of machines and ensuring quality raw materials); mid-course evaluation (ensuring progress of the project) and final stage consulting (marketing of produce and expansion plan which include possible down-stream activities). It is important to note that all the technical supports needed require that the field workers of the MFIs to be well-equipped with the skills and knowledge to convey effective advice to the recipients. There is, therefore, a need for a strong and intensive training system for the field workers as well.

5.5 Insurance policy and health awareness campaign for recipients

To avoid the recipients to use the loan for more pressing personal needs such as for medical expenses, the MFIs can require the recipient to also undertake insurance policy for health coverage. Health issue is highly relevant in microfinance since approximately 10 to 15 percent of the recipients defaulted on their loan payments to meet medical expenses for the family members. As a result, insurance policy for health coverage for the recipients could indirectly reduce the possibility of default in microfinance. In addition, as a way of prevention, the MFIs could have the health awareness campaign which include promoting cleanliness, proper sanitation and good eating habits to reduce the diseases which is quite common among the recipients.

5.6 Project-specific repayment schedule

Immediate fixed repayment schedule on either weekly or monthly basis for all type of projects has shown to be burdensome for many recipients, particularly those with business projects that require relatively long incubation period. MFIs should be aware that the time needed for a business project to turn in profit depends on the nature of business, for example, chicken-rearing farm takes at least two weeks, while goat-rearing farm takes about one to two months. In this circumstance, MFIs should discuss with the borrower and need to know the real nature of business before deciding on the repayment plan. Payment should ideally starts after the incubation period, once the farm produce can be sold. In this regard, a more flexible repayment schedule would benefit clients and potentially improve their repayment capacity.

5.7 Motivational programs for recipients

To ensure the recipients are motivated to do the best in whatever business project that they are undertaking, frequent motivational talks should be given to the recipients so as to have a paradigm shift to further improve their standard of living. At the same time, it is also important to remind the recipients of their responsibility to ensure the success of the business project, thus to be able to re-pay the MFIs of the loan that have been extended. In this regard, there is a need to enhance the poor people's self-confidence so as to make them believe that they can succeed in life if they strive for it. One way to increase the motivation of the poor is through the motivational camp which could include a series of motivational talks and some training on the basic skills and knowledge needed in running a particular type of business. The motivational camp will not only motivate the recipients but will also strengthen the creditor-borrower relationship such that the recipients will feel obligated to ensure the success of the business project so as to be able to repay the creditors as promised.

5.8 Support from Government

Since microfinance has become a major anti-poverty tool in many developing countries, microfinance could be used to complement government's objective to eradicate poverty. As such, MFIs could get the support from the government that could ensure its successful implementation. Smart partnership between the MFIs and the government would help to expedite the implementation of microfinance in poverty alleviation on a national scale basis. While the MFIs could extend financial assistance, the government could contribute in terms of promoting healthy lifestyle among the recipients as well as providing education infrastructure to the poor people. All these work hand in hand to ensure the success of microfinance projects, thus, reducing the possibility of default among the borrowers. The government could also provide a conducive environment for microfinance to grow by providing favorable tax incentives for the parties involve in microfinance.

5.9 Establish a common database of micro-finance recipients

To avoid the possibility of borrowers defaulting due to over-stretched financial commitments resulting from multiple borrowings from MFIs, there needs to be a collaborative effort among the MFIs and government to set up a common database for all microfinance recipients. This database should be accessible to all the creditors and regulators so that effective screening process can be done in terms of the eligibility for the amount of loans. The database should also provide demographic information that could reveal the risk profiles of the borrowers. This would enable to MFIs to tailor-made the loan according to the specific borrower's demographic factors. The database could also reveal the information on the level of basic training and motivational advice needed by the recipients to start the business.

5.10 Implementing the concept Islamic micro-finance

Bangladesh is a majority Muslim country where around 90 percent of its population is Muslims. Equity financing as proposed by Islamic finance could be the best solution to most of the problems highlighted. In particular, *mudharabah* and *musyarakah* (or a combination of both) can be adopted so that there will be active participation by both parties to ensure the success of a business venture. This risk-sharing concept is well-suited for microfinancing since the MFIs can provide capital and while the recipients could provide their work effort and be compensated accordingly. Since, the basic concept of *mudarabah* is that in the event of financial loss, the owner of the capital (*rabbul mal*) will bear the loss, it is then in the best interest of the MFIs to ensure close supervision of the project being undertaken.

The concept of *ijarah* (Islamic leasing) is also highly relevant in the context of microfinance. The MFIs can have ownership of the equipment or machinery needed in the business project and lease the equipment and machinery to the microfinance recipients in return for rental.[6] In return, the MFI can use utilize the concept of operational lease where the MFI will purchase and maintain assets which are necessary for the people like poultry firm or dairy firm instruments. The MFI will rent there assets to the clients on terms and conditions agreed upon for a specific time. After the termination of the period the assets will be returned to the MFI. The MFI then lease the same assets to a new lessee. The MFI will bear the risk of recession or diminishing demand for these assets. At the end, the MFI may choose to scarp or dispose the assets.

6. CONCLUSION

Since microfinance is seen as a noble effort to provide accessibility of financing to the poor people, ensuring its continuous successful implementation is therefore, very crucial. While conceptually, the implementation of microfinance is simple and results in numerous advantages to the parties involved particularly the poor people, in practice, there are several issues that need to be handled in ensuring that the objectives of microfinancing can be achieved.

This paper highlights several factors that lead to increased possibility of business failure thus, the risk of default in microfinance. Weaknesses in the post-disbursement funds administration by the MFIs has been identified as the major factor resulting in increased default risk since it provides the opportunities for the recipients to utilize the loans for other reasons than what has been agreed upon. Other lender-side factors that increase the likelihood of business failure and default risk are lack of technical assistance given to the microfinance recipients, inexperienced field workers, burdensome immediate fixed payment system and lack of common accessible database of the microfinance recipients to avoid multiple borrowings from various MFIs. There are also borrower-specific factors relating to moral hazard problem that increase the possibility of default on payment such as hiding of business, spending for more imminent needs such as medical expenses, lack of motivations to improve the standard of living and over-stretched financial commitments due to multiple borrowings from the MFIs.

Based on these factors, the paper suggests several ways to reduce these problems from occurring, thus to reduce the possibility of default in microfinance. In efforts to reduce the moral hazard problem after the funds are disbursed, there is an urgent need for the MFIs to have a monitoring system of ensuring that the funds are being spent as has been agreed upon by the recipients. It is also suggested that it is best for the MFIs to directly purchase the relevant equipment for the business project and limit the amount of cash disbursement to reduce the default risk. The MFIs can also appoint a central purchaser for the business output and require that part of the sale payment goes for payment installment to the MFIs and the balance goes to the recipients. Hence, default risks can be reduced substantially.

[6] Muhammad Yusuf Saleem, Fiqh For Economist-2 (Malaysia, IIUM, 2007) , p-35

With regard to reducing the possibility of default due to unsuccessful business venture, there is an urgent need for a strong training system for recipients and field workers of MFIs. Since health issue is highly relevant in microfinance, requiring the recipients to undertake health insurance policy as part of the microfinance package will prove to be beneficial. It is also important to increase the awareness on the importance of health among the recipients. In efforts to reduce the inability to repay due to burdensome fixed repayment schedule, it was suggested that repayment plan based on project-specific basis should be considered. On motivating the poor people so that they will give out their best to ensure the success of the microfinance project and to further improve their standard of living, conducting motivational programs can be beneficial for recipients. The programs would also to strengthen the creditor-borrower relationship such that the recipients are aware of their obligations to repay the creditors as promised, thus ensuring the success of the business projects. Since microfinance has become a major anti-poverty tool in many developing countries, microfinance could be used to complement government's objective to eradicate poverty. Smart partnership between the MFIs and the government would help to expedite the successful implementation of microfinance in poverty alleviation on a national scale basis. There is also the need to have a common database of micro-finance recipients so as to avoid the possibility of borrowers defaulting due to over-stretched financial commitments resulting from multiple borrowings from MFIs.

Last but not least, all the suggestions highlighted above can be implemented directly if the MFIs implement the concept of Islamic microfinance. Equity financing, namely *mudarabah* and *musharakah* (or a combination of both) can be adopted so that there will be active participation by both parties from the very beginning until the end to ensure the success of a business venture.

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