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Loan provision practices and borrower utilization behavior: A case study of Grand Microfinance Institution, Hawassa branch

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ABSTRACT

The objective of this study was to assess of loan provision practice of microfinance and loan utilization behavior of borrowers of microfinance institutions in Ethiopia, a case from Grand MFI institution. To this end, the researcher employed a mixed research approach with a descriptive research design to achieve the objective of the study. Primary data were collected through a structured questionnaire. A total of 267 respondents were taken as a sample and data were analyzed using descriptive statistics. The result indicates that MFI generally has good loan provision practices; however, advising the borrowers and creating awareness received less attention. Loan diversion among borrowers was commonly observed. The primary factors leading to loan diversion include borrowers' perception of loan diversion, urgent needs, diverted for domestic purposes or family needs of money, institutions less follow up with their clients, and advice given to clients during the provision of loans, and the size of loan delivered to borrowers. Therefore the institution should maintain and improve continuously the loan provision practice. It should place greater emphasis on advising borrowers, training them in the utilization of loans, and continuously following up on the clients' operation regarding loan usage.

KEYWORDS

Borrowers; Loan diversion; Loan provision; Loan provision practice; Loan utilization, Loan utilization behaviors; Microfinance institutions

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Introduction

Microfinance provides reliable, timely, and different financial services such as microloans, credit provision, savings, and micro-insurance to marginalized low-income individuals and poor people. These microfinance services are invaluable in alleviating poverty, and creating employment opportunities in various socio-economic settings [1-2]. Microcredit helps access finance for those who do not have collateral, formal employment, confirmable credit history, or other requisites of conventional banking [3]. Offering the credit to poor is vital for reducing poverty and fostering entrepreneurship. Sustainable microfinance institution is the key driver of economic growth in developing countries like Ethiopia [4].

While microfinance is increasingly acknowledged as a tool for poverty reduction in many countries, the importance of risk management should not be ignored [5]. Loan repayment challenges remain a critical issue for MFIs and are leading to failure [6]. Microfinance is required to ensure that disbursed loans are repaid, enabling them to maintain financial sustainability and successful operation [4]. Effective credit risk management involves overseeing the activities that expose an institution to credit risk. Therefore, analyzing credit risk is vital for the efficiency and success of microfinance operations. Proper credit provision practices enable effective credit management to take timely and appropriate corrective actions based on the weaknesses identified by loan officers [7].

The healthiness of loans provided to customers depends on factors such as the creditworthiness of borrowers, which is also influenced by the proper selection and evaluation process, the risk level of business, methods of business assessment, and loan

monitoring by institutions. Similarly, the types of loans offered, the adequacy of loan amounts, and collateral affect the quality of the loan [8]. Moral hazard, insufficient monitoring, high interest rates, inadequate collateral, and nepotism greatly contribute to the increase in non-performing loans [9]. According to the National Bank of Ethiopia, 2010's reports of non-performing loans; the failure of loan performance (LP) not only threatens the capability and sustainability of the MFI but also hinders the achievement of the goals.

The repayment behaviors of customers are influenced by many factors associated with customer financial situations such as consumer [9]. On the other hand, the diversion of loans contributes to the collapse in loan performance management and threatens the sustainability of MFIs. Diversion of loans increases the probability of default; it also imperils the viability of these institutions or programs in the long run [10]. Theoretical debates have highlighted differing viewpoints on clients. The intermediary viewpoint emphasizes institutional sustainability. They analyze the viability of the clients. Conversely, beneficiary viewpoints focus on whether microfinance genuinely benefits clients. Yet, there are mixed findings on whether loan diversion adversely affects client viability.

Empirical evidence, including studies from Ethiopia [11-13], indicated that clients frequently use loans for unproductive purposes. Many borrowers did not allocate the funds from MFIs to their intended and agreed uses [14] which often contributed to their inability to stay current on repayments. The diversion of loans from productive to

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non-productive purposes inevitably diminishes their potential to generate returns and increases the likelihood of default [3]. The imbalance between supply and demand is considered a driving factor for loan diversion. Pearlman, in a theoretical study, identified economic vulnerability and increased demand for microfinance [15].

The rural credit market persistently is facing loan diversion as significant challenge of their operation [6]. Its effects, including delayed loan repayment and risks to financial sustainability, should not be underestimated. Rural clients, in particular, face a heightened risk of default or delinquency due to factors such as using funds for non-productive purposes, investment failures, or refusal to repay [16]. Research by demonstrates that loan diversion significantly and adversely impacts loan repayment performance [17]. Studies regarding loan diversion are limited in number. Except for a few existing studies, loan diversion has not been studied as its effect on the operation of microfinance. Regarding Ethiopia existing studies focused on repayment and less on utilization of loans.

In line with this, the current study investigates loan provision practice of microfinance intuition and loan utilization behavior of borrowers of microfinance and more to academia. The study intends to analyze the fact of what accounts for loan diversion in Ethiopia as well as, investigate whether loan provision practices contribute to the diversion of loans.

Empirical Literature Review

Various studies have explored loan diversion from different angles, shedding light on the extent of loan diversion among borrowers and the factors contributing to it. For instance, stated that loan diversion stems from a mismatch between the demand for loans and the supply of loans [10]. Garikipati found that a considerable share of loans was redirected to household activity aimed at enhancing assets and income [18]. Similarly, Vadakarasseril identifies common causes of loan diversion, including borrower's illness, unemployment, illness of a spouse, and the educational needs of children [19]. Khaleque highlighted that 68% of the loans from microfinance were diverted to unintended use, with wage earners being prone to divert loans compared with other occupations [20]. On average more than 28% of each loan was allocated to consumption, with a lack of restriction on subsidized loans from microfinance institutions.

Burki observed that the difference between household and productive expenditure is often unclear for utilizing loans by households from microfinance, nothing that "cash is easily fungible" [21]. Similarly emphasized the prevalence of loan diversion in microfinance, noting that the likelihood of diversion increases among groups with open political affiliations [10]. Political connections often play a role, and larger loan amounts tend to result in higher rates of diversion, while larger families divert a smaller proportion of their loans. According to Hamidi, the borrower's perception and characteristics have a role in diverting the loan [22]. Their finding indicates that age, number of households, engagement in non-agricultural jobs, high interest rate, and type of loan are related to a higher risk of loan diversion.

Conversely, factors such as higher education levels, increased income, frequent monitoring by bank experts on the

agricultural use of loans, and greater mechanization helped reduce the likelihood of loan diversion. Mondal, using a descriptive analysis concluded that the credit utilization varied across farmers in Bangladesh [6]. Studies regarding the Ethiopian context, Gebeyehu, examine the major reasons contributing to loan default among small-scale enterprises [23]. The findings indicated that factors such as having additional sources of income, higher education levels, prior work experience in related economic activities, and engagement in non-agricultural economic activities positively influenced loan recovery performance.

On the other hand, loan diversion, and loan rationing mechanisms; similarly, Haji examined the factors affecting loan repayment performance among rural women-based savings and credit cooperatives in Dire Dawa, Ethiopia [24]. They concluded that factors such as loan supervision, education level, loan size, income from loan-financed activities, timely loan disbursement, suitability of loan repayment periods, income from other activities, age, participation in social festivities, and loan diversion. While loan diversion was not directly estimated or predicted, it was included as an independent variable influencing loan repayment performance. Being a male borrower, and extended loan repayment periods negatively affected loan recovery.

Abafita, analyzed loan repayment performance where wherein loan diversion is significantly and positively affected by the frequency of borrowing, whereas the suitability of microfinance loan repayment and the education level of the borrower negatively and significantly affect loan diversion in Ethiopia [25]. Similarly assessed the loan utilization and repayment behavior of borrowers [2,26]. 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 loans. Perceived reasons for loan delinquency and default are also linked to seasonal income variability.

Menza, undertook the study of factors influencing loan diversion among small-scale borrowers in Ethiopia [27]. Their finding shows that the household tends to divert loans into both productive and non-productive areas. They identified factors such as the loan's purpose, dependency ratio, supervision, and the borrower's attitude towards repayment significantly influenced the likelihood of diverting loans to more productive investments versus not diverting them. Additionally, the diversion of loans to non-productive investments was significantly affected by the borrower's sex, group size, the number of females in the group, and their repayment attitudes [28-29].

Methods and Material

Description of the study area

Grand Microfinance Institution is one of the fastest-growing microfinance institutions in Ethiopia. Grand MFI Hawassa branch currently operates in Hawassa city. Hawassa City is found in the southern parts of Ethiopia. The city serves as the capital of the Sidama region. Geographically the city is bounded by longitudes of 38° 24' 51" to 38° 33' 26" E and latitudes of 6° 54' 42" to 7° 05' 50" N [30].

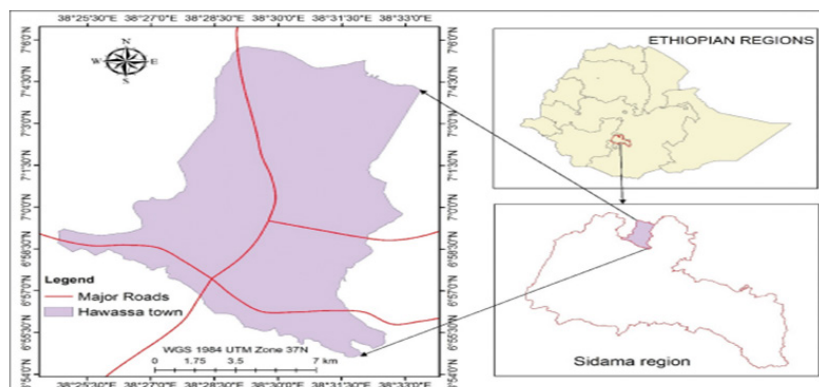


Figure 1. The map of the location of the study area.

Research design and approach

The researcher used a descriptive study design to undertake this specific study because the objective of this study was to assess loan provision practices and utilization of borrowers. The research approach employed for this study was a mixed research approach due to the qualitative and quantitative nature of the data used to undertake this study.

Data types and sources

This study employed cross-sectional survey data collected. To collect the necessary information, the study used primary sources of data. The primary data was collected through a self-administered questionnaire from representative respondents among the target population found in the study area. The data were collected from respondents borrowed from Grand MFIs whose amount is outstanding during the survey period and employees of institutions.

Sampling techniques and sample size determination

The study used multi-stage sampling techniques, which are a combination of purposive, stratification, and simple random sampling methods. In the first stage, the Grand microfinance institution Hawassa branch was selected for the study purposively. It was selected by taking into account that it diversified the loan products, portfolio, and has shown fast growth in the portfolio since its inception in Hawassa city. The institution offers different loan products such as consumption loans, micro business loans for both individuals and groups, fixed asset loans agricultural loans, energy loans, and more.

In the second stage, using a stratified sampling technique, the loan products were classified into consumption loans, micro business loans for individuals and groups, fixed asset loans agricultural loans, energy loans, and staff loans. In the third stage, a simple random sampling technique was applied to select respondents from each stratum method.

The target population of this study is 817 borrowers of Grand and 8 employees of MFI. To select a representative sample from 817 borrowers, a simple random sampling technique was employed to give equal chances for respondents and to save resources. The sample size was determined by applying Yamane's (1967) sample size determination formula as follows:

$$n = \frac{N}{1 + N(e)^2} = \frac{85}{1 + 825(0.05)^2} = 276$$

n = implies the required sample size

e = implies that the margin error that the researcher can tolerate (5%).

N = Whole Statistic Population.

Respondents from each stratum were selected proportional to the sample size. The following table displays the data collected from the institutions, which includes 8 employees [Table 1].

Table 1. Sample of respondents from clients.

S/N.	Stratum	Number of borrowers per stratum	Proportional sample size from each stratum
1	Consumption loan	606	198
2	Microbusiness loan	156	54
3	Fixed asset loan	1	1
4	Energy	35	11
5	Agricultural loan	20	7
6	Staffs	6	2
Total		825	276

Methods of data analysis

After the accomplishment of the data collection procedure, it was classified and coded; the qualitative data was coded to be measured quantitatively. In this research, the descriptive statistics of data analysis tool was employed and done by the help SPSS version 21.0 to get the reliable finding.

Results and Discussion

The researcher distributed two hundred seventy-six questionnaires to respondents. Out of the questionnaires distributed, two hundred sixty-seven questionnaires were correctly filled and returned which implies most respondents have participated in the process of data collection. Then, the descriptive statistical analysis was done using the statistical package for social science version 21.0 based on questionnaires properly collected.

Reliability analysis of questionnaires

Testing the reliability of data collected is important to assess the consistency of a questionnaire, specifically a Likert-type scale as it reflects the overall reliability of the constructs being measured. Cronbach's Alpha (α) is the most widely used measure for scale reliability, with a value above 0.700 considered highly acceptable and according to Cronbach's a value greater than 0.60 is also deemed acceptable.

Table 2. Reliability Statistics.

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
0.867	0.859	33

From Table 2, the value for Cronbach's Alpha (α) was 0.867 for all variables which is more than minimum acceptable (0.70). When these calculated reliability values for Cronbach's Alpha based on Standardized items are 0.867, which is also higher compared with the minimum value of alpha 0.70. This implies that the data fitted in the SPSS is more reliable.

Table 3. Socio-demographic characteristics of respondents.

Socio-demographic characteristics		Frequency	Percent
Gender	Male	177	66.3
	Female	90	33.7
	Total	267	100
Marital status	Married	111	41.6
	Unmarried	117	43.8
	Divorced	39	14.6
	Total	267	100
Educational background of respondents	Below certificate	9	3.4
	Certificate	70	26.2
	First degree	122	45.7
	Master's degree and above	66	24.7
	Total	267	100
Occupation of respondents	Business activity	115	43.1
	Urban agriculture	27	10.1
	Employed	107	40.1
	Other activity	18	6.7
	Total	267	100

Source: Own survey (2024)

Table 4. Loan delivery mechanism follow up procedure of microfinance institutions.

	N	Minimum	Maximum	Mean	Std. Deviation
There is sufficient assessment of the background of clients during extending the loan to them.	267	2	5	4.36	0.972
The institution assesses and examines the collateral pledged by the borrowers to screen	267	2	5	4.16	0.972
The experience in business is taken into consideration to screen and approve credit provision for clients	267	2	5	3.39	0.972
The credit term is determined based on the amount of capital during the credit provision	267	2	5	4.16	0.972
The institution is adopting rating during screening out the credit provision	267	2	5	3.46	0.954
The institution charges interest rates before on loan is extended to borrowers	267	2	5	3.46	0.954
The institution determines the loan size to clients based on their repayment capacity	267	2	5	3.48	0.954
The institution advises borrowers upon and after the loan is extended	267	2	5	2.56	0.954
The loan officers visit the business before extending the loan	267	2	5	3.46	0.954
Institutions visit the workplace frequently and advises the utilization of loan	267	1	4	2.47	1.022
The Institutions provide loans in different lending schemes	267	1	4	3.56	1.022
Valid N (listwise)	267				

Source: Own survey (2024)

In the survey conducted conveys the socio-demographic characteristics of the respondents [Table 3]. According to the sample of respondents, 66.3 % were male clients and 33.7 % were female clients. Regarding the marital status of respondents, married and unmarried clients constitute a larger portion (41.6 % and 43.8% respectively) compared to divorced (14.6%). The educational background of respondents from the table revealed most of the respondents are educated and hold a certificate, first degree, or master's (26.2%, 45.7%, and 24.7% respectively). Regarding the occupation of respondents apart from demographic characteristics, it indicated that most of the clients of the institution were engaged in business activity special micro business, and employment (43.1% and 40.1% respectively), and some of them also engaged in urban agriculture 10.1% and others.

Loan delivery mechanism follow-up procedure of microfinance institutions

This study aimed to evaluate the loan provision practices and borrower behavior in loan utilization through a survey of data gathered from respondents. Data were collected from 267 participants using questionnaires designed with a five-point Likert scale to measure their attitudes and opinions on the subject. The Likert scale ranged from strongly agree (5), agree (4), sure (3), disagree (2), to strongly disagree (1), with five items used to assess responses.

The implications of mean interoperation is strongly agreed = 5 (very high mean) with mean range of 4.20-5.00, agree = 4 (high mean) with a mean range of 3.40-4.19, Not sure = 3 (average mean) with mean range of 2.60-3.39, disagree = 2 (low mean) with a mean range of 1.80-2.59 and strongly disagree = 1 (very low mean) with mean range of 1.00-1.79. Hence, the variables in the following tables (1.4, 1.7, and 1.8) measured through 5 pint Likert scale were analyzed as follows:

Table 4 indicates the loan provision mechanism of microfinance institutions. Based on the above table, the first option is whether sufficient assessment of the background of clients made during extending loans to them [Table 4]. The mean average scale of measurement is 4.36 which falls in the range of 4.2-5.00. It indicated that the institution assesses the background information of clients during the screening process. The mean average value of the scale of measurement of the second option is 4.16 which falls in the range of 3.4- 4.19. It indicates the institution assesses and examines the collateral pledged by the borrowers during the provision of credit. The third option is about whether the experience of respondents in business is taken into consideration to screen and approve credit provisions for clients.

The average mean scale of measurement is 3.39. It falls in the range of 2.6-3.39 indicating business experience is not significant enough to approve the credit. The fourth option is about the amount of capital whose mean value is 4.16 which falls in the range of 3.4 - 4.19. It indicates that credit term is determined based on the amount of capital during credit provision. The mean average value of the fifth option is 3.46 which falls in the range of 3.4-4.19. The result indicates the institution is adopting a rating during screening out the credit provision. The average mean of sixth is 3.46 which falls in the range of 3.4-4.19. The result indicates the institution charges interest rates before a loan is extended to borrowers. The mean

value of the seventh option is 3.48 which falls in of 3.4-4.19. The result indicates that the institution determines the loan size to clients based on their repayment capacity.

From the above table the eighth option is about whether the institution gives advisees to borrowers upon and after the loan is extended. The mean value of this option is 2.56 which falls in the range of 1.8-2.59. It indicates the institution did not advise borrowers. The mean value of the ninth option is 3.46 which falls in the range of 3.4-4.19. The result indicates the institution that the loan officers visit the business before extending the loan. The average mean value of the tenth option is 2.47 which falls in the range of 1.8-2.59 which indicates Institutions did not visit the workplace frequently and advisees the utilization of loans. The average mean value for the last option is 3.56 which falls in the range of 3.4-4.19. The result indicates Institutions provide loans in different lending schemes [Table 4].

In general, the Grand MFI has more or less good loan provision practice however, regarding advising the borrowers and creating the awareness the institution was given less attention. Not only that, periodic follow-up of the operation of the client requires much attention. It helps the clients to invest money in either the proposed project or divert to the profitable project.

The following table discusses the responses and beliefs of respondents on loan utilization.

Table 5. Loan utilization behaviors of borrowers.

	N	Minimum	Maximum	Mean	Std. Deviation
All the loaned money was spent on a proposed project only	267	1	4	2.56	1.128
The money loaned from MFI was diverted into other projects	267	1	4	3.41	1.128
The money borrowed from MFIs for proposed projects can be diverted into non-proposed	267	1	4	3.49	1.128
The borrowers divert loaned money intentionally when they get potentially profitable activity	267	1	4	4.16	0.974
Institution frequently follows up the clients to collect periodic repayments only	267	1	4	4.16	0.904
Institution frequently follows up on the businesses of borrowers as they spend properly	267	1	4	2.34	0.974
The institution takes action against the borrowers when it finds the loan is diverted	267	1	4	2.35	0.974
The institution's follow-up can prevent unproductive loan diversion	267	1	4	3.48	0.874
Institution frequently follows up on the borrowers' activity, give training and advise	267	1	4	2.35	1.128
It gets difficult to repay the periodic repayment as money has been diverted into other activity	267	1	4	3.56	0.974
Valid N (listwise)	267				

Source: Own survey (2024)

Table 5 indicates the loan utilization behavior of borrowers. Based on the above table, the first option is whether all the loaned money from MFIs was spent on the proposed project properly [Table 5]. The mean average scale of measurement is 2.56 which falls in the range of 1.8-2.59. The clients did not spend the loaned money on the originally agreed project between the Institution and clients. The client diverts loans into other activities. The mean average value of the scale of measurement of the second option is 3.41 which falls in the range of 3.4- 4.19. It indicates clients have diverted loaned money into other projects however the mean value approaches to lower limit of this range indicating significant clients also did not believe in that. The third option is about whether the money borrowed from MFIs for the proposed project can be diverted into non-proposed.

The average mean of the scale of measurement is 3.49. It falls in the range of 3.4- 4.19 indicating the borrowers believe they can divert the loan to a non-proposed project because the institution does not have much advice to give clients during the provision of loan. The fourth option is about whether loan diversion is intentionally to get profitable activity whose mean value is 4.16 which falls in the range of 3.4 - 4.19. It indicates

that borrowers divert loaned money intentionally when they get potentially profitable activity. The mean average value of the fifth option is 3.46 which falls in the range of 3.4-4.19. Institution frequently follows up with the clients to collect periodic repayments only and ignore the utilization. The average mean of the sixth and seventh option (2.34 and 2.53 respectively) fall in the range of 1.8-2.59. The results indicate the Institution did not frequently follow up on the businesses of borrowers as to how spent properly on agreed projects.

Similarly, no action is taken against the borrowers when it is found loan is diverted into non-productive activity. The mean value of the eighth option is 3.48 which falls in of 3.4-4.19. The result indicates that the institution's follow-up can prevent unproductive loan diversion. From the above table ninth option is about whether the Institution frequently follows up on the borrowers' activity, gives training, and advises. The mean value of this option is 2.56 which falls in the range of 1.8-2.59. It indicates institution did not advise borrowers. The average mean of the last option is 3.56. The result indicates that the borrowers face no difficulty in repaying the periodic repayment they have diverted the loan.

Table 6. Possible causes of for diversion of loan.

	N	Minimum	Maximum	Mean	Std. Deviation
The borrowers spent the loaned money on other activities when they faced pressing need	267	1	4	4.37	1.128
The borrowers spend loaned money when one of their domestic purposes or need money	267	1	4	3.99	1.128
The borrower spent the loaned money because institutions seldom follow up with their clients	267	1	4	3.37	1.128
Borrowers can utilize the loaned money on more profitable activity gives better results than the original proposed projects.	267	1	4	4.25	1.128
Borrowers' perception of repayment and utilization contributes to the diversion of loan	267	1	4	4.31	0.974
The borrowers spend on other activities when the institution delivers less money than the proposed project requires.	267			4.45	0.903
Valid N (listwise)	267				

Source: Own survey (2024)

Table 6 provides the possible causes that lead the borrowers to divert loans. Based on the above table, the first option is whether borrowers spent the loaned money on other activities when they faced pressing needs [Table 6]. The mean average of the scale of measurement is 4.37 which falls in the range of 4.2-5. The result indicates that borrowers divert the loan when they face pressing needs. It is agreed by almost all respondents. The mean average value of the scale of measurement of the second option is 3.99 which falls in the range of 3.4-4.19. It indicates clients have diverted loaned money into other projects when one of their domestic purposes needs money. The third option is about whether the borrower spent the loaned money because institutions seldom follow up with their clients. The

average mean scale of measurement is 3.37. It falls in the range of 2.6-3.39 indicating the borrowers believe they are indifferent, this is because the institution does not have much advice to give clients during the provision of loans.

Conclusions

In this paper, the researcher assessed the loan provision of Grand MFIs and the loan utilization practice of borrowers. By keeping this objective in mind, the researcher collected the primary data through a structured questionnaire. By using SPSS version 21.0, the analysis of descriptive statistics has been done. The value for Cronbach's Alpha (α) was 0.867 for all variables which is more than the minimum acceptable (0.70). When these

calculated reliability values for Cronbach's Alpha based on Standardized items are 0.867, which is also higher compared with the minimum value of alpha 0.70. This implies that the data fitted in the SPSS is more reliable. Based on the findings MFI has more or less good loan provision practice however, advising the borrowers and creating awareness of the Institution was given less attention.

Not only that, periodic follow-up of the operation of the client requires much attention. It helps the clients to invest money in either a proposed project or divert on a profitable project. The loan utilization behavior and perception of borrowers' loan diversion are obvious among the borrowers during the study period. The borrowers used to divert loaned money into non-proposed activity. Similarly, the institution's follow-up, training, and advice to the borrowers is less. However, the diversion of loans did affect repayment ability. The basic factors that lead to loan diversion are the perception of borrowers about loan diversion, pressing needs, diverting domestic purpose or needs money, institution's less follow up their clients, and advice given to clients during provision of loan and the size of the loan.

In general, a grand microfinance institution has a concrete loan provision system, which examines the backgrounds of clients, and the collateral and assesses the ability of repayment of borrowers before the provision of loan. However, there have been significant gaps in following up with the clients. Clients receive insufficient guidance and advice from microfinances about utilization. This led many borrowers to divert their loans for unintended purposes.

Recommendation

The finding of the study has shown that MFI has more or less good loan provision practice however, regarding advising the borrowers and creating the awareness the institution was given less attention. The institution should maintain and improve continuously the loan provision practice. It should emphasize the borrowers' advice and training about the utilization of loans and continuously follow up on the operation of clients.

Regular follow-ups, such as consistent business visits, advisory support, and training on the utilization of borrowed money can help to ensure loans are used for productive purposes only. This can benefit both borrowers and institutions by improving the repayment rate of borrowers and the success of business

Disclosure statement

The authors declare no competing interests affecting this research.

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