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Original Article

Determinants of Loan Default Among Micro and Small Enterprises Financed by Saccos in Mwanza City, Tanzania

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ABSTRACT: *Loan default threatens the liquidity, sustainability and financial-inclusion role of Savings and Credit Cooperative Societies (SACCOS), particularly where they finance micro and small enterprises (MSEs) operating under volatile market conditions. This study examined the influence of administrative factors, borrower credit attributes, and economic and market factors on loan default among SACCOS-financed MSEs in Mwanza City, Tanzania. Guided by Information Asymmetry Theory, the study adopted a pragmatic philosophy and a cross-sectional mixed-methods design. Quantitative evidence from 205 respondents was analysed using descriptive statistics, Pearson correlation and ordinary least-squares multiple regression, while interviews with SACCOS officials were analysed thematically. The measures demonstrated acceptable internal consistency (Cronbach's alpha = 0.804-0.879). Administrative factors were negatively associated with default ($r = -0.618$; beta = -0.291, $p < 0.001$), as were favourable borrower credit attributes ($r = -0.674$; beta = -0.438, $p < 0.001$). Adverse economic and market factors increased default ($r = 0.591$; beta = 0.276, $p < 0.001$). The model explained 64.5% of the variance in loan default (adjusted R-squared = 0.640; $F = 124.806$, $p < 0.001$). Interviews linked these effects to inconsistent appraisal, weak post-disbursement monitoring, limited financial literacy, loan diversion, poor records, inflation and declining demand. The study concludes that borrower capability is the strongest controllable determinant of default, but its effect is conditioned by institutional administration and market shocks. SACCOS should combine evidence-based appraisal, early-warning monitoring, financial-literacy and bookkeeping support, and flexible repayment arrangements during verified economic disruptions.*

KEYWORDS: *Loan Default, SACCOS, Micro And Small Enterprises, Credit Risk, Information Asymmetry, Tanzania.*

1. INTRODUCTION

Micro and small enterprises are central to employment, household income and local economic activity, yet their growth is persistently constrained by limited access to suitable finance. Cooperative financial institutions partly address this gap by mobilising member savings and extending relatively accessible credit to borrowers who may lack conventional bank collateral or formal financial records. In Tanzania, SACCOS therefore perform both financial and developmental functions. Their capacity to sustain these functions, however, depends on the timely recycling of loan funds. When borrowers delay or fail to repay, liquidity declines, provisioning and recovery costs rise, and fewer members can access new credit (Bank of Tanzania, 2024; Tanzania Cooperative Development Commission, 2024).

The default problem is especially consequential for MSE portfolios. Many small enterprises operate informally, maintain incomplete accounts, depend on unstable cash flows and have limited buffers against inflation, competition and demand shocks. These features complicate the lender's assessment of repayment capacity. At the same time, weak appraisal, relationship-based approvals, inadequate post-disbursement monitoring and delayed recovery may allow avoidable credit risks to accumulate. Loan default is therefore unlikely to be explained by borrower conduct alone; it reflects the interaction between institutional administration, borrower capability and the external business environment.

Mwanza City offers an important setting for examining this interaction. It is a major Lake Zone commercial centre with MSEs engaged in trade, services, manufacturing, agriculture, fishing and transport. Many depend on SACCOS for working capital and expansion finance. Their revenues are nevertheless exposed to seasonality, market competition and changes in consumer purchasing power. Evidence from commercial banks or larger urban economies may not adequately represent the member-owned, socially embedded lending relationships of Mwanza SACCOS.

Previous studies have frequently isolated governance, appraisal, borrower literacy, collateral or macroeconomic conditions. This fragmentation leaves limited evidence on their simultaneous contribution within Tanzanian SACCOS. The present study addresses that gap by examining three integrated predictors: administrative factors, borrower credit attributes, and economic and market factors. It asks how each predictor influences loan default among SACCOS-financed MSEs in Mwanza City and identifies the determinant with the greatest explanatory contribution.

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2. THEORETICAL AND EMPIRICAL REVIEW

2.1. INFORMATION ASYMMETRY THEORY

The study was guided by Information Asymmetry Theory. Akerlof (1970) demonstrated how unequal information can impair market exchange, while Spence (1973) explained how observable signals reduce uncertainty. In credit markets, Stiglitz and Weiss (1981) showed that lenders cannot perfectly observe borrower risk and behaviour. Two related problems arise. Adverse selection occurs before lending when incomplete information prevents lenders from distinguishing relatively safe borrowers from high-risk applicants. Moral hazard occurs after disbursement when borrowers divert funds, undertake undisclosed risks or withhold information because lenders cannot fully observe their actions.

The theory maps directly onto SACCOS lending. Administrative systems determine the extent to which borrower information is collected, verified and updated. Proper appraisal, objective approval criteria, clear repayment conditions and continued monitoring narrow the information gap. Borrower attributes such as repayment history, financial literacy, stable income, business experience and record keeping act as signals of creditworthiness. Loan diversion, poor records and delayed disclosure of business problems amplify uncertainty and moral hazard. Economic volatility further complicates prediction because accurate information at approval may become obsolete when inflation, interest costs or customer demand change.

Information Asymmetry Theory is useful but incomplete. It explains screening and monitoring failures more directly than genuine external shocks. A responsible and transparent borrower can still default after a severe fall in demand or rise in input costs. The study therefore uses the theory as its principal explanatory lens while empirically testing whether external market conditions add explanatory power beyond institutional and borrower information.

2.2. EMPIRICAL EVIDENCE AND HYPOTHESES

Administrative quality is repeatedly associated with portfolio performance. Effective appraisal establishes whether projected cash flows can service debt, while monitoring identifies diversion or deterioration before arrears become severe. Kapinga and Temu (2023) link stronger credit-risk management to improved repayment in Tanzanian SACCOS, and Ouma and Were (2020) similarly emphasise appraisal and follow-up in East African cooperative lending. Accordingly, the study expected stronger administrative practices to reduce default.

Borrower credit attributes affect both actual capacity and the lender's ability to evaluate it. Financial literacy improves budgeting and understanding of loan conditions; records make business cash flow observable; experience supports operational decisions; and a positive repayment history signals willingness to honour obligations. Njeru and Kimani (2021) identify borrower attributes as important predictors of default, while Lusimbo and Muturi (2016) connect financial capability with repayment. The study therefore expected favourable borrower attributes to reduce default.

External conditions determine whether enterprises can convert effort and credit into cash flow. Inflation raises input costs, high lending costs increase debt-service burdens, competition compresses margins, and declining demand weakens revenues. Institutional reports similarly emphasise the vulnerability of small firms to economic shocks (International Monetary Fund, 2024; World Bank, 2023). The study expected adverse economic and market conditions to increase default.

3. METHODOLOGY

The study adopted a pragmatic philosophy and a cross-sectional mixed-methods design. Pragmatism was appropriate because the research problem required both numerical estimates of relationships and practical accounts of how default occurs. The study covered eight selected SACCOS in Mwanza City: Mkolani, Bugando, Mwandoyi, Jumaki, Wanawake Mwanza, Kizimkazi, FCA Buhongwa and Mwanza City SACCOS. The target population comprised MSE borrowers with recent loan experience and officials responsible for appraisal, administration, monitoring and recovery.

The dissertation determined a planned sample of 205 from a finite population of 420 using Yamane's (1967) formula. The analytical dataset contained 205 valid respondent records, as reflected in the descriptive totals and regression degrees of freedom. Borrowers were selected through multistage and simple random procedures from participating SACCOS records, while knowledgeable SACCOS officials were selected purposively for interviews.

A structured questionnaire measured administrative factors, borrower credit attributes, adverse economic and market factors, and loan default on five-point Likert scales. Semi-structured interviews explored appraisal, monitoring, borrower behaviour, market pressures and mitigation measures. Expert review and pilot testing supported content validity. Cronbach's alpha values were 0.842 for administrative factors, 0.816 for borrower credit attributes, 0.879 for economic and market factors, 0.804 for loan default and 0.847 overall, exceeding the conventional 0.70 threshold (Hair et al., 2019).

Quantitative data were analysed using descriptive statistics, Pearson correlations and ordinary least-squares multiple regression. The model was specified as $LD = \beta_0 + \beta_1 AF + \beta_2 BCA + \beta_3 EMF + \varepsilon$, where LD denotes loan default, AF administrative factors, BCA borrower credit attributes and EMF adverse economic and market factors. Statistical significance

was evaluated at ρ<0.05. Diagnostic tests indicated acceptable multicollinearity (VIF = 1.486-1.825), homoscedasticity (Breusch-Pagan chi-square = 2.846, ρ=0.416), and approximately normal residuals (Shapiro-Wilk W = 0.992, ρ=0.218). Interview data were coded thematically and integrated with quantitative findings through triangulation. Participation was voluntary, confidentiality was protected, and responses were used for academic purposes.

4. RESULTS

4.1. RESPONDENT AND LOAN PROFILE

Of the 205 respondents, 57.6% were men and 42.4% were women. The largest age category was 30-39 years (35.1%), followed by 40-49 years (28.3%). Most had secondary education (42.0%) or a certificate/diploma (28.3%). Trade accounted for 40.0% of enterprises, and services for 34.2%. Nearly half (46.8%) had two to five years of SACCOS loan experience. Although 62.9% reported regular repayment, 37.1% were classified as having defaulted, demonstrating a material portfolio-quality concern.

TABLE 1 Descriptive Results For The Principal Study Variables

Construct	Overall Mean	Standard Deviation	Interpretation
Administrative factors	3.87	0.87	Generally, favorable practices
Borrower credit attributes	4.09	0.80	Strong perceived importance
Economic and market factors	4.21	0.75	High external pressure

Respondents rated economic and market pressures highest (M = 4.21), followed by borrower attributes (M = 4.09) and administrative factors (M = 3.87). Inflation (M = 4.36), profitability (M = 4.33), repayment history (M = 4.32) and economic instability (M = 4.29) were among the most highly rated individual indicators.

4.2. CORRELATION RESULTS

TABLE 2 Pearson Correlations Among Study Variables

Variable	1	2	3	4
1. Administrative factors	1			
2. Borrower credit attributes	.542***	1		
3. Economic and market factors	.487***	.563***	1	
4. Loan default	-.618***	-.674***	.591***	1

*Note. *** p < 0.001 (two-tailed).*

Administrative factors were strongly and negatively related to default (r = -0.618, ρ<0.001). Favourable borrower credit attributes displayed the strongest bivariate relationship (r = -0.674, ρ<0.001). Adverse economic and market factors were positively related to default (r = 0.591, ρ<0.001). Correlations among predictors remained below 0.80, consistent with the VIF diagnostics.

4.3. REGRESSION RESULTS

TABLE 3 Multiple Regression Predicting Loan Default

Predictor	B	SE	Beta	T	P
Constant	5.214	0.352	-	14.812	<.001
Administrative factors	-0.318	0.061	-0.291	-5.213	<.001
Borrower credit attributes	-0.452	0.058	-0.438	-7.793	<.001
Economic and market factors	0.287	0.054	0.276	5.315	<.001

Model statistics. R = 0.803; R-squared = 0.645; adjusted R-squared = 0.640; standard error = 0.418; F(3, 201) = 124.806, p < 0.001.

All three predictors were statistically significant. Better administrative practice reduced loan default (beta = -0.291), and favourable borrower attributes produced the largest reduction (beta = -0.438). Adverse economic and market conditions increased default (beta = 0.276). Together, the predictors explained 64.5% of the variation in default. The estimated equation was: Loan default = 5.214 - 0.318(AF) - 0.452(BCA) + 0.287(EMF).

4.4. QUALITATIVE FINDINGS AND INTEGRATION

Interviews clarified the processes behind the statistical relationships. Officials reported that formal appraisal procedures were sometimes applied inconsistently and could be weakened by personal relationships, member recommendations or management pressure. Limited staffing, transport and financial resources restricted routine visits after disbursement, while recovery often began only after arrears had accumulated. These accounts explain why stronger administrative factors were associated with lower default.

Borrower-level themes included limited financial literacy, failure to separate household and business money, weak bookkeeping, diversion of business loans to school fees, ceremonies or construction, and delayed communication of repayment

difficulty. In contrast, borrowers who valued their SACCOS relationship and disclosed problems early were easier to support. These mechanisms are consistent with the dominant regression effect of borrower attributes.

Officials also identified rising input prices, declining consumer purchasing power, seasonal sales, higher lending costs and economic uncertainty. Even well-managed enterprises experienced repayment pressure when margins contracted. The qualitative and quantitative convergence strengthens the credibility of the results and demonstrates methodological triangulation.

5. DISCUSSION

The negative administrative coefficient confirms that loan default is partly an institutional management outcome. Thorough appraisal helps determine whether enterprise cash flow can support the proposed repayment schedule; monitoring verifies loan use and detects deteriorating performance; and early recovery prevents minor arrears from becoming non-performing loans. This agrees with evidence that stronger appraisal and credit-risk management improve cooperative loan performance (Kapinga & Temu, 2023; Ouma & Were, 2020). The qualitative accounts add an important governance qualification: written procedures are insufficient when approvals remain susceptible to relationships or managerial pressure.

These results strongly support Information Asymmetry Theory. Inadequate verification permits adverse selection because high-risk applicants may appear similar to sound borrowers. Weak post-disbursement monitoring creates moral hazard by making diversion or undisclosed risk-taking less observable. Administrative controls reduce both problems by converting private borrower information into verified institutional evidence. The implication is not simply to demand more collateral, but to improve the timeliness and quality of information throughout the loan cycle.

Borrower credit attributes had the largest standardized effect. Financial literacy, record keeping, stable income, repayment history, business skills and productive loan use improve both repayment capacity and observability. This finding is consistent with Njeru and Kimani (2021) and Lusimbo and Muturi (2016), who emphasise borrower characteristics and financial capability. For SACCOS, the practical value of these attributes is twofold. They directly improve enterprise cash-flow management, and they signal creditworthiness to the lender. Conversely, poor records and loan diversion obscure business performance and increase moral hazard.

The positive effect of adverse economic and market conditions shows that default cannot be reduced to opportunistic borrower conduct. Inflation raises costs, falling demand reduces revenue, and interest burdens absorb cash that would otherwise service debt. This finding accords with wider evidence on SME vulnerability to economic shocks (International Monetary Fund, 2024; World Bank, 2023). It also identifies the boundary of Information Asymmetry Theory: complete information cannot prevent a genuine market shock. Information can nevertheless improve preparedness by enabling stress testing, sector-based risk assessment and earlier restructuring.

The integrated model therefore offers a more complete explanation than any single factor. Borrower capability is the strongest controllable determinant, administrative systems shape the quality of lending and monitoring, and the external environment determines whether projected cash flows remain feasible. Policies focused only on recovery after default are consequently unlikely to be sufficient.

6. CONCLUSION AND IMPLICATIONS

Loan default among SACCOS-financed MSEs in Mwanza City is a multidimensional outcome. Stronger administrative practices and favourable borrower credit attributes significantly reduce default, whereas adverse economic and market conditions increase it. Borrower attributes exert the greatest relative influence, but they operate within lending systems and markets that can either reinforce or weaken repayment capacity. The evidence validates the central Information Asymmetry argument that incomplete information increases adverse selection and moral hazard, while extending the theory by demonstrating that genuine external shocks remain consequential even when information is adequate.

For SACCOS management, appraisal should combine repayment history, verified cash-flow records, business experience and purpose-specific loan analysis. Relationship-based exceptions should require independent review and documented justification. Post-disbursement monitoring should be risk-based, with automated reminders, early-warning indicators and prompt engagement before arrears become severe. Staff responsible for appraisal and recovery require continuous training and manageable caseloads.

Borrower development should be treated as credit-risk management rather than a peripheral social service. Short, compulsory modules on budgeting, separation of household and business funds, bookkeeping, loan conditions and cash-flow planning should precede disbursement. Higher-risk borrowers should receive mentoring and periodic record reviews. During verified economic shocks, SACCOS should consider temporary rescheduling or seasonal repayment plans instead of waiting for otherwise viable businesses to become irrecoverable.

For regulators and cooperative support institutions, minimum expectations for appraisal documentation, portfolio monitoring, and reporting should be reinforced. Shared credit information and digital record systems could reduce repeated borrowing and strengthen screening, while sector and inflation indicators could support portfolio stress testing. These interventions can protect SACCOS liquidity without undermining access to finance for viable MSEs.

7. LIMITATIONS AND FURTHER RESEARCH

The cross-sectional design identifies statistically significant relationships but cannot establish temporal causality. Likert-scale responses may be affected by recall or social-desirability bias, and the focus on selected Mwanza SACCOS limits direct generalisation to other regions and financial institutions. Future research should use longitudinal loan-account data, compare cooperative and commercial lenders, and test behavioural, governance and digital-finance determinants. Multilevel studies could also examine whether sector, SACCOS governance or economic conditions moderate borrower-level effects.

DECLARATIONS

- Ethics and consent to participate: Participation was voluntary. Respondents were informed of the academic purpose of the study, confidentiality was protected, and no personally identifying information is reported.
- Conflict of interest: The author declares no conflict of interest.
- Funding: The study received no specific grant from any public, commercial or not-for-profit funding agency.
- Data availability: Anonymised data may be made available by the author upon reasonable request, subject to ethical and institutional requirements.
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